ROYAL COMMISSION ON INDIAN FINANCE AND CURRENCY.

FINAL REPORT

OF

THE COMMISSIONERS.

Presented to both Houses of Parliament by Command of His Majesty.

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THE ROYAL COMMISSION.

GEORGE, R.I.

GEORGE THE FIFTH, by the Grace of God, of the United Kingdom of Great Britain and Ireland and of the British Dominions beyond the Seas, King, Defender of the Faith, Emperor of India, to

Our Right Trusty and Well-beloved Counsellor Joseph Austen Chamberlain;

Our Right Trusty and Well-beloved Edmund Beckett, Baron Faber;

Our Right Trusty and Well-beloved Arthur, Baron Kilbracken, Knight Grand Cross of Our Most Honourable Order of the Bath; and

Our Trusty and Well-beloved:—

Sir ROBERT CHALMERS, Knight Commander of Our Most Honourable Order of the Bath, Permanent Secretary to the Treasury;

Sir ERNEST CABLE, Knight, formerly President of the Bengal Chamber of Commerce;

Sir SHAPURJI BURJORJI BROACHA, Knight, formerly Sheriff of Bombay.

Sir JAMES BEGBIE, Knight, Secretary and Treasurer of the Bank of Bombay.

ROBERT WOODBURN GILLAN, Esquire, Companion of Our Most Exalted Order of the Star of India, Secretary to the Government of India in the Finance Department;

HENRY NEVILLE GLADSTONE, Esquire; and

JOHN MAYNARD KEYNES, Esquire, Fellow of King's College in Our University of Cambridge, and Lecturer in Economics,

Greeting!

Whereas We have deemed it expedient that a Commission should forthwith issue

To inquire into the location and management of the general balances of the Government of India; the sale in London of Council Bills and Transfers; the measures taken by the Indian Government and the Secretary of State for India in Council to maintain the exchange value of the rupee in pursuance of or supplementary to the recommendations of the Indian Currency Committee of 1898, more particularly with regard to the location, disposition, and employment of the Gold Standard and Paper Currency Reserves; and whether the existing practice in these matters is conducive to the interests of India; also to report as to the suitability of the financial organisation and procedure of the India Office; and to make recommendations:

Now know ye, that We, reposing great trust and confidence in your knowledge and ability, have authorised and appointed, and do by these Presents authorise and appoint you, the said Joseph Austen Chamberlain (Chairman); Edmund Beckett, Baron Faber; Arthur, Baron Kilbracken; Sir Robert Chalmers; Sir Ernest Cable; Sir Shapurji Burjorji Broacha; Sir James Begbie; Robert Woodburn Gillan; Henry Neville Gladstone and John Maynard Keynes to be Our Commissioners for the purposes of the said enquiry.

And for the better effecting the purposes of this Our Commission, We do by these Presents give and grant unto you, or any three or more of you, full power, at any place in Our said United Kingdom of Great Britain and Ireland, to call before you such persons as you shall judge likely to afford you any information upon the subject of this Our Commission; and also to call for, have access to and examine all such books, documents, registers and records as may afford you the fullest information on the subject, and to inquire of and concerning the premises by all other lawful ways and means whatsoever.

And We do by these Presents authorise and empower you, or any three or more of you, to visit and personally inspect such places as you may deem it expedient so to inspect for the more effectual carrying out of the purposes aforesaid.

And We do by these Presents will and ordain that this Our Commission shall continue in full force and virtue, and that you, Our said Commissioners, or any three or more of you, may from time to time proceed in the execution thereof and of every matter and thing therein contained, although the same be not continued from time to time by adjournment.

And We do further ordain that you, or any three or more of you, have liberty to report your proceedings under this Our Commission from time to time, if you shall judge it expedient so to do.

And Our further will and pleasure is that you, with as little delay as possible, report to Us under your hands and seals, or under the hands and seals of any three or more of you, your opinion upon the matters herein submitted for your consideration.

Given at Our Court of St. James's, the seventeenth day of April, one thousand nine hundred and thirteen, in the third year of Our Reign.

By His Majesty's Command,
R. McKENNA.

Indian Currency and Finance.
Royal Commission of Inquiry.

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REPORT TO THE KING'S MOST EXCELLENT MAJESTY.

MAY IT PLEASE YOUR MAJESTY,

WE, the undersigned Commissioners appointed to inquire into the location and management of the general balances of the Government of India; the sale in London of Council bills and transfers; the measures taken by the Indian Government and the Secretary of State for India in Council to maintain the exchange value of the rupee in pursuance of or supplementary to the recommendations of the Indian Currency Committee of 1898, more particularly with regard to the location, disposition, and employment of the Gold Standard and Paper Currency Reserves; and whether the existing practice in these matters is conducive to the interests of India; also to report as to the suitability of the financial organisation and procedure of the India Office; and to make recommendations; humbly submit to Your Majesty the following Report:—

I.—INTRODUCTORY.

1. We have held 34 meetings and have examined 33 witnesses. In order that full opportunity might be given for an expression of the views of the various persons and bodies interested in the subjects of our inquiry, we decided at our first meeting to request the Government of India through the Secretary of State to issue a public invitation in India for representative witnesses to appear before us; and arrangements were made for facilitating the attendance of those who had to travel specially from India to London for this purpose. Twelve witnesses representative of the commercial, financial, and banking interests throughout India attended as the result of this invitation; while two other witnesses, Mr. Marshall Reid, C.I.E., and Mr. M. de P. Webb, C.I.E., who attended in response to our direct invitation, may be included in the same category. Several others, who were prevented from one cause or another from fulfilling their original intention of appearing before us for examination, have submitted statements of their views, which are printed among the appendices to our Reports, together with similar statements from others who were either unable to accept the invitation to give oral evidence or were asked by us to express their views in writing instead of attending in person.

2. Of the remaining nineteen witnesses, two were former chairmen of the Finance Committee of the India Council, one is the present chairman and one a present member of that Committee, one is the broker to the Secretary of State for India, and four are members of the India Office permanent staff, making nine witnesses in all who were directly or indirectly representatives of the India Office. The Government of India selected four witnesses to represent them, including Mr. Bhupendra Nath Mitra, C.I.E., Assistant Secretary to the Government of India in the Finance Department, and Sir James Meston, K.C.S.I., now Lieutenant-Governor of the United Provinces, and a former Secretary in the Finance Department. In addition to these official representatives of the Government of India, Sir Guy Fleetwood Wilson, K.C.S.I., &c., who had recently retired from the position of Finance Member of the Viceroy's Council, and Mr. F. C. Harrison, C.S.I., a former Accountant-General at Bombay, attended as witnesses at our invitation.

3. The remaining four witnesses comprise a representative of the Bank of England, two representatives of the Exchange Banks doing business in India, and Mr. Moreton Frewen, who came before us at his own request. His special object was to express the views of those who desire to see the Indian mints re-opened to the unrestricted coinage of silver.

4. Our reference indicates the following main subjects for our inquiry: the general balances of the Government of India and of the India Office in India and London respectively: the sale of Council drafts by the Secretary of State in London: the Gold Standard Reserve: the Paper Currency Reserve: the system by which the exchange value of the rupee is maintained: and the Financial Organisation and Procedure of the India Office.

5. At a very early stage in our inquiry we came to the conclusion that we could not deal adequately with these subjects unless we also considered the questions of the establishment of a Central or State Bank for India, and the provision of facilities in India for the coinage of gold.

6. All these questions are closely interconnected. Much of the criticism directed against the Indian Government and the India Office, both in the evidence given

before this Commission and elsewhere, has been founded on a mistaken attempt to deal with one or other of these questions separately, and a failure to consider the Indian financial and currency system as a whole. This tendency has been accentuated by the absence of any full or clear exposition of that system by the responsible authorities. The appendices to our reports contain a series of official memoranda and despatches which go far towards filling this gap, whilst the historical summary which we give in the next section should suffice to make that system, its objects and its methods, readily intelligible to anyone who is interested in them.

7. This system is the outcome of the reports of two Committees anterior to this Commission as modified or developed by the experience gained in succeeding years. It must be remembered that even the Committee of 1898 had little experience to guide them. Some of their recommendations were tentative and experimental. They contemplated developments, the exact course of which it was impossible for them to foresee, and they certainly had no desire to bind the Government of India to a particular solution of questions of detail which further experience might show to be unnecessary or undesirable. Their main object was to establish a stable rate of exchange, and all their other recommendations were directed to this great purpose. It is no matter for surprise if, in applying a novel policy to constantly changing conditions, official declarations have not always been entirely consistent or official action always free from hesitation. But we desire at the outset of our report to record our high opinion of the ability and skill with which the complicated duties connected with Indian finance have been discharged by the permanent officials to whom they have been entrusted both in India and in London. Lord Inchcape, who had special opportunities of judging of their work and whose wide experience of business gives special weight to his judgment, summed up his opinion in the words (*qu.* 10,867), "I have often wished that I had some of them in my office," whilst Sir Felix Schuster, the present chairman of the Finance Committee, spoke (*qu.* 10,987) of "the great ability and businesslike manner with which the work was carried on by the officials." Those of us who have had no official connection with Indian administration or the India Office express our hearty concurrence in this well merited praise.

8. Much of the report of the Committee of 1898 was occupied with the discussion of the merits of the policy of closing the Indian mints to the unrestricted coinage of silver. We do not think it necessary to go over this ground again. Whatever were the arguments for or against this step at the time it was taken, only one witness now appeared to advocate its reversal, and his advice was conditional on the attainment of a limited international agreement to maintain the price of silver. We are not in a position to say whether such an agreement could be obtained, but in any event we regard it as no longer necessary in the interests of India. As pointed out by Sir James Meston on behalf of the Government of India, much of the extra taxation imposed on India during the time when the Government were struggling against their exchange difficulties has been remitted since the rupee has been fixed on a stable basis; and with the single exception already quoted, every witness who came before us explicitly or by implication condemned the idea of a reversal of the policy of 1893 and 1898. It appears to us to be impossible to deny, in face of all the evidence, that India has derived enormous benefits from the substitution of gold for silver as the standard of value, and India's future prosperity is, in our opinion, bound up with the maintenance of the gold standard. We proceed, therefore, to the consideration of the steps which should be taken in pursuance of the policy recommended by the Committtee of 1898.

9. The first principle to be borne in mind in any consideration of the Indian finance and currency system is that the balances of the Government of India in India, and of the India Office in London, and the portions of the Gold Standard and Paper Currency Reserves located respectively in India and in London, all represent in the last analysis one single fund. The titles attached to the constituent portions of this fund indicate to some extent the nature of the needs and liabilities for which the fund as a whole is required to provide. The name attached to each portion indicates the primary function of that portion; but neither in theory nor in practice have the separate portions of the fund been entirely reserved for the objects indicated by their separate names.

10. The needs and liabilities for which these resources are required to provide may be summarised under the following five heads:—

(i) A working balance in India for (*a*) the current expenditure on revenue and capital account of the Imperial and Provincial Governments throughout India,

(b) the expenditure of local boards and municipalities for which the Central Government act as banker, (c) the Government savings banks, and (d) miscellaneous funds and services such as funds in court.

(ii) A working balance in the United Kingdom for the "home charges" of the Government of India on revenue and capital account, including the capital outlay of most of the Indian railway systems.

(iii) A reserve fund for the maintenance at the par of 1s. 4d. per rupee of the exchange value of the rupee with the sovereign.

(iv) A fund for securing the convertibility of the notes of the Government of India.

(v) The provision in India of fresh supplies of coined rupees and of sovereigns as at present at the rate of one sovereign per 15 rupees.

In addition the system at present in force is used to provide facilities for remittance to India by means of Council bills and telegraphic transfers of such sums as may be required to meet the balance of trade in India's favour. This use of Indian balances is limited only by the amount of the resources available in India to meet the sales, subject, however, to the notification that bills will be sold indefinitely at 1s. $4\frac{1}{8}$d. per rupee.

11. We propose to take as the first subject for examination the currency system of India, viz., the internal currency of India and the system by which a fixed rate of exchange is maintained between the media of internal circulation and the currencies of other countries which, like India, have a gold standard. The proposed mint for the coinage of gold in India, the Gold Standard Reserve, and the Paper Currency Reserve will naturally be dealt with under this section of our report. A detailed examination of the general balances of the Government of India, both in India and London, and of the system of sales of Council drafts, will form the next section of our report.

The two next sections will be concerned with the financial organisation and procedure of the India Office and the question of the establishment of a State or Central Bank, and in the last section will be found a summary of our conclusions.

II.—INDIAN CURRENCY SYSTEM.

(1) History since 1893.

12. We shall begin our inquiry into the currency system of India by giving a summary of the main events affecting Indian currency which led up to the appointment of the Indian Currency Committee of 1898 or have taken place since the date of their Report.

13. Prior to the closing of the Indian mints to the unrestricted coinage of silver in 1893, the Indian currency system was a monometallic system with silver as the standard of value and a circulation of silver rupees and notes based on them. For the settlement of India's obligations to countries in which gold was the standard of value the rupee was exchangeable at the gold value of its silver content, and the balance of trade, then as now usually in India's favour, was settled by the import of silver bullion into India, where it could be coined at the mints into rupees at the option of the holder.

The main object of the closing of the mints to the unrestricted coinage of silver was to remedy the state of things resulting from the fall in the gold value of the rupee owing to the fall in the gold price of silver. This fall had for some time been a source of great difficulty to India, because it increased the burden measured in rupees of the external obligations of India payable in gold, while great uncertainty was introduced into the finances alike of Government and of trade by the fluctuations of exchange.

14. The closing of the mints to silver in 1893 led, as was intended, to a gradual divergence between the exchange value of the rupee and the gold value of its silver content. After a somewhat heavy coinage of rupees in 1893 the Government ceased to add rupees to the circulation. Rupees remained unlimited legal tender, and formed the standard of value for all internal exchanges. Since the Government refused, and no one else had the power, to coin rupees, as soon as circumstances led to an increased demand for rupees, the exchange value of the rupee began to rise. In 1898, soon after the Indian Currency Committee of that year was appointed, it became for the first time profitable for persons out of India who had payments to make in India to take advantage of the standing offer of the Government of India

(made in 1893 in the form of a notification under an Indian Act of that year) to give rupees at the Calcutta or Bombay mints, or to issue notes at the paper currency offices, against gold tendered to them at a rate of exchange equivalent to 15 rupees for 1*l.* sterling. In short, the exchange value of the rupee had then reached 1*s.* 4*d.*

15. So long as the offer of the Government of India to give rupees in exchange for gold at 1*s.* 4*d.* per rupee remained in force and the Government were prepared to maintain a supply of rupees sufficient for this purpose, there was obviously no possibility of exchange rising above 1*s.* 4*d.* by more than the cost of shipping gold to India. But it was always possible that a falling off in the demand for currency might result in exchange dropping below 1*s.* 4*d.* by more than the cost of shipping gold from India to London, unless the Government were able and willing to give gold in exchange for rupees at 1*s.* 4*d.*, or to sell sterling exchange at a fixed rate without limit—an offer to which the Government have never in fact bound themselves.

Throughout the years 1898 and 1899 conditions favoured the maintenance of the exchange rate of 1*s.* 4*d.*, and by the end of 1899, the year in which the Committee of 1898 issued their Report, over 4,500,000*l.* of gold tendered in exchange for rupees at 1*s.* 4*d.* had been accumulated in the Paper Currency Reserve in India.

16. Such was the situation which faced the Committee of 1898. That Committee necessarily devoted considerable attention to the suggested reopening of the Indian mints to the unrestricted coinage of silver, and, in the event of the alternative policy being continued, to the consideration of the exact rate at which the exchange value of the rupee should finally be fixed. They decided against the reopening of the mints, and in favour of fixing the rupee at 1*s.* 4*d.*, and these recommendations were accepted by the Secretary of State and the Government of India. The important part of the Committee's Report for the purposes of this historical summary is therefore that which deals with the measures recommended for giving permanence to the *de facto* position in 1898–9 so far as concerns the exchange rate of the rupee.

17. The Committee had before them several schemes for giving fixity to the exchange. The scheme which they recommended was not, however, a cut and dried plan with all its details worked out in advance. They confined their recommendations to the indication of certain general principles to be followed in advancing towards an ultimate goal. What this goal was may be gathered from the following passages from their Report:—

Para. 51.—" We are of opinion that the habit of hoarding does not present such " practical difficulties as to justify a permanent refusal to allow India to possess the " normal accompaniment of a gold standard, viz., a gold currency."

Para. 54.—" We are in favour of making the British sovereign a legal tender and a " current coin in India. We also consider that at the same time the Indian mints " should be thrown open to the unrestricted coinage of gold on terms and conditions " such as govern the three Australian branches of the Royal Mint. The result would " be that, under identical conditions, the sovereign would be coined and would " circulate both at home and in India. Looking forward as we do to the effective " establishment in India of a gold standard and currency based on the principles of " the free inflow and outflow of gold, we recommend these measures for adoption."

Para. 55.—" Under an effective gold standard rupees would be token coins, sub- " sidiary to the sovereign. But existing conditions do not warrant the imposition of " a limit on the amount for which they should constitute a legal tender; indeed, for " some time to come no such limitation can be contemplated."

18. It is clear that the Committee looked forward to the ultimate establishment in India not merely of a gold standard but also of a gold currency in active circulation, and meanwhile contemplated an approximation to the French system of currency in which gold coins and silver five-franc pieces are alike unlimited legal tender. This involved the dethronement of the rupee within a comparatively short time from its position as the sole or principal medium of exchange and the establishment of the sovereign as an effective rival.

19. In addition to the suggestions for the attainment of this object which are mentioned in the passages quoted, viz., the making of the sovereign a legal tender and the opening of the mints to the coinage of gold, the Committee recommended further (in para. 60) that " fresh rupees should not be coined until the proportion of gold in the currency is found to exceed the requirements of the public," and that " any profit on the coinage of rupees . . . . should be kept in gold as a special " reserve, entirely apart from the Paper Currency Reserve and the ordinary Treasury " balances."

The use to be made of this reserve is indicated in the following passage (para. 59):—

"Although the Government of India should not, in our opinion, be bound by law " to part with its gold in exchange for rupees, or for merely internal purposes, we " regard it as the principal use of a gold reserve that it should be freely available " for foreign remittances whenever the exchange falls below specie point; and the " Government of India should make its gold available for this purpose, when " necessary, under such conditions as the circumstances of the time may render " desirable . . . and, when it has accumulated a sufficient gold reserve, and so " long as gold is available in its Treasury, it might discharge its obligations in " India in gold, instead of in rupees."

It will be observed that "the effective establishment of a gold standard" was the paramount object which the Committee of 1898 set before the Indian authorities. The other recommendations which we have quoted were made only because they were considered to be necessarily connected with that supreme purpose.

20. These recommendations were accepted in their entirety by the Indian authorities. It remains to consider shortly the history of events since 1899. In one respect this history is very simple. In 1898 the exchange value of the rupee touched 1*s*. 4*d*. for the first time since the closing of the mints to silver, and, except for one temporary fall to below specie point for a brief period during the crisis of 1907–8, it has remained fixed at the par of 1*s*. 4*d*. ever since.

21. This simple statement does not, however, reveal the underlying complexities of the story.

The Indian Act No. XXII. of 1899 making the sovereign and half sovereign legal tender throughout India at 15 rupees to the £ gave effect to the first recommendation of the Committee. This remains the only statutory provision for the rating of the rupee at 1*s*. 4*d*., and has the effect of providing a statutory means of preventing the rupee from rising above the par of 1*s*. 4*d*. But it is obvious that this Act does nothing to prevent the rupee from falling below 1*s*. 4*d*., and would be a dead letter if at any time it became cheaper to give 15 rupees in settlement of a debt than to give one sovereign.

22. Active steps were taken at the same date to give effect to the second recommendation, viz., the opening of a mint for the coinage of gold in India. The scheme was dropped after nearing completion in 1902, and has only recently been revived. But the knowledge that steps were being taken in this direction during the years 1899 to 1902 perhaps contributed to convince public opinion in India and elsewhere that the Government were determined to maintain the gold standard.

23. The third recommendation of the Committee was that the profits on the coinage of rupees should be set apart and kept in gold as a special reserve. The Gold Standard Reserve, as it is now called, is the outcome of this recommendation. By the middle of January 1900 the stock of gold in the Paper Currency Reserve in India had reached 5,000,000*l*. Though gold coins were now legal tender in India, the public continued to demand rupees, and the Government had to consider whether they should resume the coinage of rupees, for the first time since 1893.

24. The provisions of the Act of 1893 and the notification issued by the Government thereunder of their readiness to accept gold at the mints and Paper Currency Offices at the rate of 15 rupees to the £ had been supplemented in 1898 by an Act which authorised the issue at the same rate of notes in India against gold deposited in London and earmarked at the Bank of England as part of the Paper Currency Reserve. This Act was at first intended to be temporary. Its effect was to facilitate Government remittances to London, to add to the gold resources of India, and to give some elasticity to the currency by allowing of the issue of rupees or notes in India against gold tendered in London. But this additional issue of currency against gold tendered in London added to the drain on the rupee reserves of the Government in India.

25. In view of this drain, the Government of India proceeded to carry out the recommendations of the Committee of 1898 by making an active effort to induce the people of India to use sovereigns as a medium of circulation. The Currency Offices were instructed to offer sovereigns to presenters of notes, while giving rupees to any one who objected to receiving sovereigns, and at the same time the Post Offices and other institutions under Government control were utilised to press sovereigns on the public. The results were unsatisfactory. Many of the gold coins soon made their way back into Government's hands, and the Government found themselves unable to

cash currency notes in rupees not only at the Cawnpore and other treasuries in the North West Provinces (where though not legally bound to do so, they had been in the habit of encashing notes), but on the 11th April 1900 at the Head Office in Calcutta itself. Notes became subject to a discount of as much as $\frac{7}{16}$ths per cent. in Cawnpore, and there was serious danger of a failure of confidence in the paper currency. Meanwhile sovereigns also went to a discount of as much as 4 annas in many places. Special demands for rupees, owing to famine conditions, and the inadequacy of the supplies of the favourite circulating medium combined to aggravate the general monetary stringency.

26. In these circumstances the Government of India resumed the coinage of rupees early in 1900 on a considerable scale. Recourse to the London silver market soon became necessary, and the Act of 1898 just mentioned was continued for a further period of two years with the addition of a provision authorising the use of the gold held in the Paper Currency Chest in London for the purchase of silver for coinage of rupees and the treatment of the silver so purchased as part of the Reserve against notes in circulation during the interval between purchase and mintage. An Act of 1902 made the whole of these provisions permanent.

Since 1900 the Government of India have not repeated the experiment of forcing gold coins into circulation, and in many years the coinage of rupees has been on a very large scale.

27. It was decided in 1900 to follow the recommendation of the Committee of 1898 and to form a special reserve from the profits on the coinage of rupees as they accrued. The Government of India put forward proposals for the formation of such a reserve in their despatch No. 302 of the 6th September 1900 (Appendix V., p. 109). Their idea seems to have been to keep the reserve in gold locked up in a special chest in India. The decision of the Secretary of State, however (as given in his despatch No. 232 of the 13th December 1900, Appendix V., p. 126), was that the profits should be remitted to London and invested in sterling securities. It was held that since London was the place in which the Reserve would have to be applied on the occasion of the emergency against which it was being created, London would be the best place in which to keep it.

28. For the first few years from 1901 onwards the profits on the coinage of rupees were accordingly remitted home by the shipment of gold to London for investment, the gold being taken out of the accumulations in the Paper Currency Reserve in exchange for the freshly coined rupees. The interest earned on the securities purchased was also added to the Gold Reserve. These securities were at the outset Consols only, but in 1903 investments were made also in National War Loan Stock and other stocks, such as Local Loans. This extension of the area of investment seems to have been dictated at the time mainly by the desire to avoid too large holdings of one security and to earn a better rate of interest.

29. In 1905 the sterling resources of the Government of India in London were further increased by the shipment to London of 5,000,000 sovereigns out of the accumulated stocks in the Paper Currency Reserve in India, to be held as part of that Reserve in London. With a continuance of the favourable balance of trade these stocks of sovereigns had continued to increase, and the difficulties of the Government since 1899 had been, not in the direction of keeping exchange up to 1*s*. 4*d*., but in providing sufficient rupees to meet the demands of the public, which continued to demand rupees rather than gold. The advantage of shipping these sovereigns to London and keeping them there was that they could be used there, as and when required, in purchasing silver, thus saving the three or four weeks' delay involved in shipping them from India at the moment when actually required.

30. In 1906 the same difficulty in meeting the demands for rupees led to the formation in India of a special reserve for this purpose outside the Paper Currency Reserve. At first this reserve had been held inside the Paper Currency Reserve in silver ingots, and then in partly-coined rupees, but finally in 1906 the more natural course of holding the reserve in fully-coined rupees was adopted. The fact that this reserve was needed in order to prevent the possibility of the exchange value of the rupee going to a premium over 1*s*. 4*d*. through a failure in the supply suggested that its cost might be charged against the Gold Reserve by the simple process of holding the profits on the coinage of the rupees in the Reserve in the form of rupees in India instead of converting them into sterling held in London. The name of this Reserve was thereupon changed to the Gold Standard Reserve, which thenceforward consisted of two portions, one held in sterling securities in London and the other in India in rupees.

31. Meanwhile, the practice of shipping to London gold accumulated in the Paper Currency Reserve in India, either to form part of the Gold Standard Reserve or to be earmarked in London against the Paper Currency Reserve, was recognised to be needlessly expensive. The gold, it was seen, reached India in the first place at the cost of individuals, and then had to be shipped back to London by and at the cost of Government after the public had handed it on to the Government in exchange for rupees. By an extension of the practice of receiving gold in London in exchange for rupees in India, Indian Revenues could be saved the expense of shipping gold to London, and by the offer of remittances to the public in the form of Council Drafts could realise in the price paid for these Drafts a large part of the sums previously paid for freight and insurance on the shipment of gold to India.

32. Accordingly the practice introduced in 1898 of selling Council Drafts for gold in London and issuing notes against such gold in India was extended, and since 1904 the Secretary of State has kept open a standing offer to sell Council Bills without limit at the price of 1*s.* $4\frac{1}{8}$*d.* When the demand for these Drafts is very strong and the Treasury balances of the Government of India are insufficient to meet them, they are met by the withdrawal of rupees from the Paper Currency Reserve in India against a corresponding deposit of gold in the Currency Chest in London, and if necessary by the withdrawal of rupees from the Indian Branch of the Gold Standard Reserve. The Government meanwhile purchase silver, if necessary, in London out of the proceeds of the Council Drafts sold there and ship it to India to be coined into rupees.

33. The price of 1*s.* $4\frac{1}{8}$*d.* for Council Bills approximates to the normal gold export point from London to India, but is not at all times prohibitive of such export of sovereigns, and the India Office have not desired that it should be prohibitive; nor does it prohibit the export of sovereigns to India from Egypt or Australia. Accordingly, when sovereigns continued to accumulate inconveniently in the hands of Government in India, it was decided in 1905 to offer Telegraphic Transfers against sovereigns in transit from Egypt or Australia to India at rates of 1*s.* 4*d.* or 1*s.* $4\frac{1}{32}$*d.*, calculated to make it worth the while of the owner of such sovereigns to divert them from India to London.

34. Under these arrangements it has not since 1905 been necessary, as a general rule, for the Government of India to ship sovereigns on their own account from India to London, except in the case of light coin; and remittances for the purpose of adding the profits on coinage to the Gold Standard Reserve or for adding to the gold earmarked for the Paper Currency Reserve in London have been made by means of the sale of Council Drafts. None the less gold continues to go to India in considerable quantities in busy seasons both in the form of bullion and in the form of sovereigns, and the accumulations of gold in the Paper Currency Reserve at such times continually threaten to embarrass the Government.

35. In June 1907 a Committee appointed by the Secretary of State to consider the question of Indian railway finance recommended (in an Interim Report) that 1,000,000*l.* out of the profits on the coinage of rupees in 1907 should be devoted to the provision of additional rolling stock and other improvements for Indian railways. They were led to this conclusion by a consideration of the urgency of the need for railway development and the impracticability of borrowing the extra sum needed at that date. They justified their proposal by the following review of the strength of India's resources against a fall in exchange, which we quote as throwing light on what may be regarded as the official view at that time of India's currency system :—

"The object of the Gold Standard Reserve . . . is to enable the Government " of India and the Secretary of State to meet their sterling obligations in the event of " a falling off in the demand for Council Bills. This reserve at the present time " consists of sterling securities of the market value of 12,310,629*l.*, together with a " sum of six crores of rupees (equivalent to 4,000,000*l.*) which is held in silver in " India to meet any sudden demand for coinage. In addition to the Gold Standard " Reserve, there is a large amount of gold (11,066,000*l.*, of which 7,705,000*l.* is held " in London and 3,361,000*l.* in India) in the Paper Currency Reserve, which could " be applied to the same object. Apart, therefore, from the six crores in silver, " there is at the present moment a fund of upwards of 23,000,000*l.* in sterling " securities and gold bullion which could be drawn upon in case of necessity."

36. The Secretary of State went beyond the Committee's recommendation and decided that for the future one half of any profits on the coinage of rupees should

be used for capital expenditure on railways until the Gold Standard Reserve reached 20,000,000*l*. It was apparently contemplated that, after that total had been reached, the whole profits on silver coinage should be diverted from the Reserve. This decision was strongly criticised in India, where the recent diversion of 4,000,000*l*. of the Gold Standard Reserve from the function of maintaining exchange to the provision of a reserve of rupees had already been regarded with disfavour, and the Government of India, in a telegram dated the 24th June 1907, followed by a despatch dated the 8th August 1907 (Appendix V., pp. 158 and 160), urged that the portion of the Gold Standard Reserve held in sterling securities should be allowed to accumulate to 20,000,000*l*. before any further sums were diverted from it. The Secretary of State, however, proceeded to use 1,123,000*l*. of the profits of coinage for railway capital expenditure, and adhered to his decision as to the use of future profits. "The danger," he stated in a telegram dated the 2nd July 1907, "which you " allege of a fall in exchange I regard as illusory, having regard to the present " conditions of trade, the amount of securities in the Gold Standard Reserve, and of " gold in the Currency Reserve."

37. The events of 1907–8, however, modified the outlook, and before any further profits on silver coinage accrued, the decision to divert part of them was reversed in 1909 (despatch No. 82 of 2nd July 1909, App. V., p. 175), and the sum of 1,123,000*l*. diverted in 1907 is all that was actually appropriated to capital expenditure.

38. The events of 1907–8 also falsified the expectations of the India Office in regard to the maintenance of the favourable conditions of Indian trade, and for the first time since the rupee was fixed at 1*s*. 4*d*., the Gold Standard Reserve and the other sterling resources of the Government of India had to be utilised to maintain exchange.

39. A partial failure of the summer monsoon in 1907, and the general monetary stringency all over the world which accompanied the American financial crisis in the autumn of 1907, caused the Indian exchange to become very weak in November of that year. The stock of sovereigns in the Paper Currency Reserve in India began to fall, their place being taken by rupees. The Government of India were asked by the Exchange Banks to sell telegraphic transfers on London at 15 rupees to the £, and, after consulting the Secretary of State, refused. Then the Government of India refused to give gold from the Paper Currency Reserve for export in larger quantities than 10,000*l*. to any one individual in one day, but continued to give gold for internal purposes; and as a consequence the exchange in Calcutta fell on 23rd November to as low as 1*s*. $3\frac{23}{32}$*d*. British Postal Orders for 10,000*l*. and other large sums began to be bought as a means of obtaining remittance to London. Thereupon the Secretary of State urged the Government of India to give gold for export, and being unable to sell Council Drafts, released gold from the Paper Currency Reserve in London against the transfer of an equivalent amount of rupees from the Treasury balances to the Paper Currency Reserve in India. This action, and the action of the Government of India, who, following the advice from home, consented to give out gold for export, improved exchange, which had recovered by 3rd December 1907 to 1*s*. $3\frac{7}{8}$*d*. in Calcutta. The suggestion of the Secretary of State that telegraphic transfers up to 250,000*l*. should be put up to tender by the Government in India at not less than 1*s*. $3\frac{27}{32}$*d*. was not therefore immediately acted upon, but the Exchange Banks were informed on the 7th December that the Government, in the event of serious weakness in the exchange, contemplated offering for tender in India sterling exchange on London.

40. As the normally busy season went on, rates remained weak, and the sale of Council Drafts continued impossible; finally it was decided on the 4th March 1908 to make weekly sales in India of a certain maximum quantity of sterling bills at the fixed rate of 1*s*. $3\frac{29}{32}$*d*., instead of telegraphic transfers by tender at not less than 1*s*. $3\frac{27}{32}$*d*. as previously proposed, and on the 26th March 1908 such bills were first sold. Meanwhile the Secretary of State had taken steps to realise some of the securities belonging to the Gold Standard Reserve in order to have money ready to meet the bills sold in India. Bills continued to be sold freely in India from this date until, on 11th September 1908, the position of exchange appeared to have become sufficiently strong, and the Government of India announced the discontinuance of their offer.

41. In all, 8,058,000*l*. was withdrawn during this period from the Gold Standard Reserve to meet the bills, while a further sum of 933,749*l*. was temporarily borrowed from that Reserve and used to strengthen the India Office balances. The sale of Council Drafts in London naturally ceased during this period, but the India Office

kept themselves in funds, apart from this transfer from the Gold Standard Reserve, by the transfer of 4,530,000*l.* from the gold in the Paper Currency Chest in London (replaced, as already explained, by the addition of rupees to the Paper Currency Reserve in India) and by the issue of India Bills to the amount of 4,500,000*l.* to meet the deficit in revenue which accompanied the crisis in India. We shall return to these figures later, when considering the special question of the proper amount and disposition of the Gold Standard Reserve.

42. Since 1907–8 India has enjoyed a period of exceptional prosperity, and during this period the demand for remittances from London to India has been so strong as not only to call for the re-issue of the large stocks of rupees accumulated in India during the crisis of 1907–8, and thus incidentally to restore the Gold Standard Reserve in London to its former amount, but also to necessitate large coinages of fresh rupees in 1912–3 and 1913–4, the profit on which has gone to increase the Reserve far beyond the maximum point reached before 1907–8.

43. The only important developments affecting the Reserve since 1907–8 have been in the direction of making it more liquid. Partly owing to conditions affecting all gilt-edged stocks with no due date for redemption, and partly owing to a clearer perception of facts, the authorities responsible for the Reserve have reduced the holding of Consols and other similar securities, and have invested in preference in short-term securities, such as Exchequer Bonds and Treasury Bills. Mainly under pressure from the Government of India the Secretary of State has cancelled the decision of 1907 to divert one-half of the profits of fresh coinage, and has introduced (in 1909) the practice of holding part of the Reserve in the form of money lent out at short notice, whilst in 1912 he began to accumulate a portion in actual gold earmarked at the Bank of England. The total which the Secretary of State has expressed his intention so to accumulate is fixed at present at 5,000,000*l.* (India Office Despatch, No. 76, of 28th June 1912, App. V., p. 201).

(2) The Indian Currency System as it exists at present.

44. It will be clear from the above summary that the measures taken to maintain the exchange value of the rupee have been, to use the words of our reference, less in pursuance of the recommendations of the Committee of 1898 than supplementary to them. As already pointed out the Indian authorities duly carried out the recommendations of the Committee to make the sovereign legal tender in India, and to establish a Gold Reserve. But their first efforts to force the sovereign into circulation having failed, they abandoned the attempt actively to encourage the circulation of a gold currency in India, and, as a corollary of this change of tactics, they kept the Gold Reserve in London for use in support of exchange.

45. The investment of the Gold Standard Reserve in securities in London, the dropping of the scheme for a gold mint in India, the practice of selling Council Drafts at something below gold point against the Currency Reserve, the establishment of the silver branch of the Gold Standard Reserve, the diversion in 1907 of money from that Reserve for capital expenditure and its use in 1908 for meeting drafts sold by Government in India on London to private traders, are all examples of divergences from the scheme adumbrated by the Committee. Thus, in spite of the fact that the Government adopted and intended to carry out the recommendations of the Committee of 1898, the Indian currency system to-day differs considerably from that contemplated by the Committee, whilst the mechanism for maintaining exchange has some important features in common with the suggestions made to the Committee by Mr. A. M. Lindsay. The system actually in operation has accordingly never been deliberately adopted as a consistent whole, nor do the authorities themselves appear always to have had a clear idea of the final object to be attained. To a great extent this system is the result of a series of experiments.

46. But to state this is by no means to condemn the action taken or the system actually in force. Indeed, it is fairly certain that a too rigid adherence by the authorities since 1899 to any one preconceived course would have had unfortunate results. The experience gained from Indian experiments in currency from 1893 onwards, and the experience of British Colonies, such as the Straits Settlements, and of other countries, such as the Philippines, which have followed the Indian example, have thrown much new light on the working of currency laws. It is possible now, looking back on events in the light of this experience, to see that the present Indian system has close affinities with other currency systems in some of the great European

countries and elsewhere, but it was universally believed in 1893 and 1899 that what was being done in India was an entirely new experiment.* This being so, the Indian authorities exercised a natural discretion in interpreting the recommendations of the Committee of 1898.

47. But it is desirable that, in the light of experience gained since 1898, an attempt should now be made to review and restate the principles which should guide the authorities responsible for the Indian currency system. Although the first efforts actively to encourage the use of gold in circulation in India proved a failure and have not been repeated, many people in India still regard the recommendations of the Committee of 1898 as laying down the principles on which the currency system should continue to be developed. We have had it in evidence from one of the non-official witnesses (*Q.* 3977) that he personally does what he can to encourage the people with whom he comes in contact to use sovereigns rather than rupees, and the evidence which we have received shows the existence of a widespread belief both in official and in unofficial circles that a gold currency in active circulation is the final goal to be aimed at.

48. The crisis of 1907–8 was the first great test to which the Indian currency system, as developed since the date of the Report of the Committee of 1898, was put, and the arrangements made for maintaining the exchange value of the rupee stood the test well. The sudden fall of exchange to 1*s.* $3\frac{23}{32}$*d.* in Calcutta in November 1907 was due, not to any insufficiency in the sterling resources of the Government but to a temporary failure to utilise those resources properly. No one in either official or unofficial circles had any experience of the machinery required for meeting the crisis, nor had any plans been fully worked out in advance for dealing with such a crisis. As may be seen from the interim report of the Indian Railway Committee of 1907 already quoted, the India Office apparently believed that the sole, or at any rate the main, purpose of the Gold Standard Reserve was to meet the requirements of the Secretary of State in London when Council Drafts could not be sold, while the Government of India made the mistake of refusing to give gold from the Paper Currency Reserve for export, though allowing their gold to be drained away for internal uses. Both authorities thus failed to recognise the wisdom of the recommendation of the Committee of 1898 that the principal use of a gold reserve is that it should be freely available for foreign remittances whenever the exchange falls below specie point. But it is fair to add that the Committee of 1898 themselves seem to have believed that a cessation of the sale of Council Drafts combined with the use of funds from the Gold Standard Reserve for meeting the requirements of the Secretary of State in London would suffice to maintain exchange, without any provision of gold by the Government for private export.

49. These mistaken ideas were, however, very quickly rectified in practice, and the steps taken to restore and maintain exchange proved adequate. It is easy to see after the event that in this or that point a mistake was made, but, regard being had to the difficulties and the novelty of the circumstances, the final success achieved by the Indian authorities both in India and in this country must be recognised as a proof of the soundness of the currency scheme itself and of the measures ultimately taken for meeting the crisis.

50. The first lesson to be learnt from the experience of the last fifteen years is that the Indian currency system has not developed on the lines of the system adumbrated by the Committee of 1898, viz., a gold standard based on a gold currency in active circulation, such as the system in the United Kingdom is commonly held to be. On the contrary it was proved in the crisis of 1907–8 that the gold in circulation in India was of very little value for maintaining the exchange. The Indian system, as the crisis of 1907–8 revealed it, is, as we have said, more like the system advocated by Mr. A. M. Lindsay in 1898, viz., a gold standard supported by gold in reserve, with a currency for internal use composed mainly of rupees and notes. The chief

* But *cf.* Plato, Laws, Book V., p. 742:—"[The citizens of the Ideal State] will require a currency "for the purpose of everyday exchange: this is practically indispensable for workers of all kinds, and "for such purposes as the payment of wages to wage-earners. To meet these requirements, the citizens "will possess a currency which will pass for value among themselves but will not be accepted outside "their own boundaries. But a stock of some currency common to the Hellenic world generally [*i.e.*, of "international currency] will at all times be kept by the State for military expeditions or official missions "abroad such as embassies, and for any other necessary purposes of State. If a private citizen has occasion "to go abroad, he will make his application to the Government and go, and on his return, if he has any "foreign currency left over in his possession, he will hand it over to the State, receiving in exchange the "equivalent in local currency."

difference between Mr. Lindsay's system and the present system is that, instead of the reserve depending mainly on the power to borrow in a crisis, an actual reserve of gold or sterling assets has been provided.

51. Experience has further shown that, though in origin and machinery the Indian currency system based on what is now known as the gold exchange standard is different from the currency systems of such countries as Russia, Holland, Japan, or Austria-Hungary, yet in actual practice these latter systems are not very different from that of India. In these countries, as in India, gold actually in circulation is of secondary importance, and the internal medium of circulation, whether it be a silver coin or a paper note, depends for its value in exchange, not on its own intrinsic worth, but on the maintenance in reserve of gold or resources readily convertible into gold, and in the case of Russia and Japan, at any rate, large portions of the gold resources are held not at home, but in London, Paris, and other monetary centres, just as India's Gold Standard Reserve is held in London.

52. A third lesson which the crisis of 1907–8 teaches is the desirability of formulating in advance and giving publicity to the policy which it is intended to pursue in a crisis. It is almost as important that the general public should have confidence in the determination of the Government effectively to use their resources to maintain the rupee at 1*s.* 4*d.*, as it is that the Government should have the necessary resources for so doing.

(3) Internal Currency of India.

(a) *Gold in Internal Circulation.*

53. From time immemorial India has continually absorbed the precious metals. But in quite recent years gold has been imported into India in the form of bullion or of sovereigns in greatly increased quantities. Apart from imports of gold bullion, the absorption of sovereigns by the public for all purposes (hoards, circulation, and the melting pot) during the 12 years ending the 31st March 1913, that is, the excess of the net amount imported over the amount retained in the hands of the Government, somewhat exceeded 60,000,000*l.*, an amount little less in value than the new coinage of rupees during the same period. Between the 1st April 1909 and the 31st March 1913 the absorption of sovereigns by the public was close on 30,000,000*l.* (*see* Appendix I., page 21).

54. To what extent and how widely the sovereign has established itself as an actual medium of circulation, it is difficult to determine with any great degree of certainty. On the one hand, it is quite certain that a large portion of these 60,000,000 sovereigns is not in active circulation, and that in many parts of the country the public have shown a preference in currency uses for rupees (or notes). But there is undoubted evidence that in the last four years there has been a distinct increase in the use of the sovereign for purposes of currency in certain provinces and districts, such as parts of the Bombay Presidency and of the United Provinces, the Punjab, and Cochin in the Madras Presidency. Speaking generally, no district which wanted gold seems to have experienced in the last four years any difficulty in obtaining it.

55. In these circumstances it cannot be maintained that the public have been prevented from obtaining gold by the course pursued by the Government. On the contrary, the official policy has been to give the public whatever form of currency they wanted, and the only official preference for one form of currency over another which we can trace is, as already recorded, in favour of gold. Those, therefore, who advocate a gold currency for India, meaning by this the use of gold coins on an extensive scale for internal circulation, must take the responsibility of urging the Government of India to force upon the public more of a particular form of currency than they at present want. It may be added, at this point, that the majority of the witnesses heard by us were distinctly unfavourable to the coinage of a 10-rupee gold piece. There is little reason to believe that it would be any more popular as a medium of internal circulation than is the sovereign, while there are strong *primâ facie* objections to the introduction of a new gold coin slightly more expensive and less convenient than the sovereign, which has been gaining an ever-increasing range of general acceptability for the purpose of meeting payments outside India. On the other hand, in so far as a 10-rupee piece was successful, it would be likely to prove a more dangerous rival than the sovereign to the smaller denominations of notes.

56. Is it then desirable that the Government of India should urge or encourage the circulation of the sovereign? The chief arguments which have been adduced in favour of such action appear to be as follows :—

(i) That gold is a more convenient and portable medium of circulation than the rupee.
(ii) That a gold currency is a necessary step towards what may be regarded as the ideal currency, viz., paper backed by gold in reserve.
(iii) That some prestige attaches to the possession of a gold currency, whereas a silver circulation is the mark of less progressive peoples.
(iv) That a large amount of gold in circulation is a strong, and, in the view of some people, the only adequate support for exchange.
(v) That the constant mintage of fresh supplies of rupees is objectionable, and would be obviated by an increasing circulation of sovereigns.
(vi) That until India has a gold currency in active circulation, India will continue to possess an artificial and managed currency.
(vii) That India should be encouraged to absorb gold in order to protect the world in general from a further rise of prices due to the greatly increased production of gold.

57. The first argument is valid only in so far as concerns large payments which for any reason cannot be discharged in notes; but India must continue for many years to use rupees for payment of the small amounts which form the bulk of internal transactions.

58. On the second argument we would say that history gives no support to the view that a paper currency can only be reached after a gold currency has been in circulation. A paper currency, if readily encashable, is the most economical medium of circulation, and at the same time provides a readily available reserve of gold for foreign remittances.

59. The argument that some prestige attaches to the possession of a gold currency is chiefly due, we think, to a confusion between a gold standard, which has undoubtedly become in the last forty years the mark of a progressive people, and a gold currency, in the sense of a preponderating use of gold for the purpose of effecting internal exchanges. So far as the internal circulation is concerned, a widespread use of cheques is generally agreed to be the most progressive system. After this comes the use of notes, which compose by far the greater part of the currency of most European countries. The preponderating use of gold coin is not characteristic of a single one of the Great Powers of the world, and it may be said that the only country which really conforms to this ideal is Egypt, where the continual inflow and outflow of sovereigns is an economic loss to Egypt herself and a cause of recurrent inconvenience to the money markets of the world.

60. The fourth argument, that the encouragement of a gold circulation is calculated in the long run to strengthen exchange, is probably that which carries most weight, and has been supported before us, in one form or another, by several witnesses who were in a position to speak with some authority. It requires, therefore, careful consideration.

61. In the first place, some witnesses seemed to imply that, if gold were to be used in India to the same extent that it is, say, in the United Kingdom or in Germany, the exchange problem would have been largely simplified. We think that this view is mistaken. The ability of these countries to meet at all times their immediate foreign indebtedness depends on the central reserves of the banks of these countries, on the influence exerted by these banks on the other constituents of the money market, and on their bank rate policy. It is not possible to point to any occasion in contemporary history on which sovereigns in the pockets of the people have proved a resource on which to count for easing the situation when a monetary crisis threatens the Bank of England's gold reserve. So little are the authorities of the Reichsbank impressed by the value of gold in active circulation for the purpose of settling international indebtedness, that they have been lately engaged in an active policy of replacing some part of this gold by notes of smaller denominations than were formerly current, whilst the gold itself has been used to strengthen the central reserve. It is useless to suppose that the advantages of the existing monetary system of the United Kingdom can be obtained for India by imitating what is, perhaps, the least vital part of this system, namely, the use of sovereigns for that small class of payments which are made in actual cash, while

ignoring the nature of the complex banking and financial system upon which the stability of exchange really rests.

62. In the second place, it is important that advocates of a gold currency should be clear as to the scale on which they think it would be feasible and wise to introduce such a currency in the near future. If it is their desire and their intention that gold should be used in active circulation to the same extent that it is used, for example, in Egypt, then no doubt gold from circulation would be available for export in considerable quantities at times of depressed trade. For, in that country a large part, measured in value, of the total transactions, instead of a very small percentage, as is the case both in the United Kingdom and in India, is carried out with gold, so that a contraction in the amount of business is likely to release a nearly proportionate amount of gold for export. It order to attain, however, to this state of affairs in India, or even to approximate to it, it would be necessary to reduce the note issue to a comparatively insignificant position, and to withdraw from circulation, at large expense, no inconsiderable part of the existing circulation of rupees. If, however, the advocates of a gold currency contemplate only such an addition of gold to the currency as can be made through the gradual increase of the aggregate circulation, without detriment to the existing circulation of notes or withdrawal of rupees now circulating, gold must continue to occupy for a good many years to come no more than a subsidiary position in the currency system. We do not believe that exchange would materially benefit from the circulation of gold on this scale. There would still be so many rupees in circulation that a considerable quantity could be spared at times of depressed trade, and it would be rupees which, as at present, would flow back into the hands of the Government at such times. All experience goes to show that, so long as the public have the option of making payments in tokens or in gold, it is the surplus tokens and not the gold in circulation which will seek an outlet at a time of weak exchange; and this will continue until the supply of tokens has been so far contracted that they are no more than sufficient for the ordinary business in the transaction of which coins of a low denomination are alone convenient. Thus it is a mistake to believe that to have 10 or 20 per cent. of the total active circulation in the form of gold means 10 or 20 per cent. of the advantages, such as they are, of having nothing but gold in circulation. During the crisis of 1907–8, while 4,179,000*l*. in gold was withdrawn by the public from the Paper Currency Reserve, only 250,000*l*. was exported on private account. We do not believe, therefore, that the circulation of gold on a moderate scale only would materially reduce the liabilities which Government ought to be prepared to meet.

63. In the third place, it is of great importance to consider from what source any gold which may find its way into circulation is likely to come. If the gold merely takes the place, not of notes or of rupees now circulating, but of new rupees which it would be necessary otherwise to mint, the effect is to diminish the strength of the Gold Standard Reserve by the amount of the profit which would have been made from the new coinage. This would bring to an end the natural growth of the Gold Standard Reserve (except in so far as its present funds might be invested and earn interest), and it is very improbable that so moderate a public circulation of gold as could possibly be obtained in this way would be as valuable in supporting exchange as gold, even though of a less aggregate quantity, in the Gold Standard Reserve. But it has to be remembered that India's demand for additional currency has been exceedingly irregular; and it would be rash to base currency policy on the assumption that this demand will be large, on the average, over the period of years immediately in front of us. For if, on account of a falling off in the demand for additional currency or for any other cause, such as a greater success in the popularisation of gold than most of its advocates now anticipate, gold in circulation were to take the place of notes or of rupees now circulating, the necessary and immediate consequence of this must be a rapid depletion of the gold now held by Government in the Paper Currency Reserve. Now it must be conceded, and has in fact been acknowledged by most of the witnesses who have pressed for a gold currency, that, sovereign for sovereign, gold in circulation is less effective than gold in reserve for supporting exchange. The depletion, therefore, of the gold in the Paper Currency Reserve, which now serves as a substantial aid to the Gold Standard Reserve in the support of exchange, might gravely weaken the Government's position at a time of exchange difficulties; and the policy of popularising gold, so far from helping exchange, would have jeopardised it. Advocates of a gold currency are met, therefore, by the difficulty that the circulation of gold on a moderate scale only is of no substantial use, while, on the other hand, the circulation of gold on a large scale, at any time in the near

future, must necessarily be at the expense of the existing Reserves and, so far from increasing the gold in the country, must have the effect of making what gold there is less available for the support of exchange. Advocates of this policy have also to remember that every step in the direction of popularising gold makes it more likely that people will cling to the gold they have and seek to obtain what additional gold they can, on any occasion of crisis or general want of confidence.

64. The argument that the coinage of fresh rupees is objectionable and ought to be avoided is largely bound up with the argument just examined; for the possible danger to exchange of a very large circulation of tokens is the main ground of the objection. But this is a convenient place at which to point out that it is by no means certain that an increase of gold in circulation will be altogether at the expense of rupees. In many respects gold is a far more formidable rival to the note issue than to rupees, since for many purposes a coin of so high a value as the sovereign cannot possibly take the place of rupees, whilst experience elsewhere has shown that a public preference for gold, or alternatively for notes, is largely a matter of habit and custom. To habituate a people, therefore, to the use of sovereigns is almost certain in the long run to militate against the use of notes, even though at first the sovereign is able in some cases to obtain a vogue where, at present and immediately, this is not possible for notes. A people who have adapted their habits to the use of gold will not easily be won from them, so long as gold is easily available. Advocates of a gold currency have repeatedly told us in evidence that they by no means advocate gold in preference to notes, which they regard as a more desirable form of currency; but the policy they favour may have, nevertheless, the consequence they deprecate. There is, indeed, some evidence that the increased popularity of the sovereign in certain districts during the last two years has already hindered in some degree the growing use of notes. In his latest report (for 1912–3) the Head Commissioner of Paper Currency states (paragraph 59):—

> "In paragraph 44 the conclusion has been drawn that gold has replaced rupees to a large extent in the Punjab, and to a smaller extent in Bombay and the United Provinces also. The question now arises whether the increased use of gold has affected the note circulation at all. In the Punjab it is certain that the circulation of 5 and 10 rupee notes has been affected. The gross circulation of the 5 rupee note after nearly doubling in the three years 1908–9 to 1911–2 increased by ·5 per cent. only in 1912–3. The gross circulation of the 10 rupee note in 1910–1 was more than double what it was three years before. In the last two years it has increased by 1 per cent. only. These figures considered in conjunction with the large increase in the use of sovereigns in the last two years are irresistible.
>
> "In Bombay the gross circulation of the 10 rupee note after increasing by nearly 30 per cent. in the two years 1908–9 to 1910–1 has increased by ·6 per cent. only in the last two years.
>
> "On the whole, it may now be definitely stated that, but for the use of gold as currency, the circulation of the smaller currency notes would have expanded much more rapidly in the Punjab, Bombay, and the United Provinces."

65. This conclusion is corroborated by some interesting figures placed before us by the National Bank of India and by the Presidency Banks as to the percentage of their receipts and disbursements at various centres in the form of notes, rupees, and gold respectively (*see* Appendix XVIII., pp. 541, 542, and Appendix XLIII., pp. 724–726). It is remarkable how uniformly in districts where the use of gold is considerable the use of notes is below the average.

66. There remains the argument that without gold in active circulation India's currency system must remain a "managed" system, it being implied that a managed system is a bad system. The ideal with which this managed system is contrasted seems to be the system of the United Kingdom where fresh supplies of the only unlimited legal tender coins, the sovereign or the half sovereign, can be obtained at will by anyone who takes gold to the mint for coinage.

In our opinion this contrast is of no value. There does not appear to us to be any essential difference between the power to import sovereigns at will and the power to have gold coined into sovereigns in India. The only point of the criticism that India's currency system is managed in a sense that is not true of the currency of the United Kingdom lies in the fact that the rupee is a token passing at a value above its intrinsic value and at the same time is unlimited legal tender. It is true that it is not practicable even to consider the limitation of the amount for

which the rupee is legal tender. In this sense therefore the system must remain a managed one. But we demur altogether to the idea that because it is to this extent a managed system it must be a bad system. It is not, in fact, possible for the Government of India to manipulate the currency for their own ends, and they cannot add to the active circulation of the currency except in response to public demands.

67. With the argument that India should be encouraged to absorb gold for the benefit of the world in general we do not propose to deal. The extent to which India should use gold must, in our opinion, be decided solely in accordance with India's own needs and wishes, and it appears to us to be as unjust to force gold coins into circulation in India on the ground that such action will benefit the gold-using countries of the rest of the world as it would be to attempt to refuse to India facilities for obtaining gold in order to prevent what adherents of the opposite school have called the drain of gold to India. In any case these arguments (which it will be noted are mutually destructive) are irrelevant to the inquiry which we were directed to make and to the terms of reference, which confine us to a report on what is "conducive to the interests of India." They raise vast controversies upon subjects which are beyond our scope, while giving no reason for the adoption of either policy in India's own interest.

68. We conclude therefore that it would not be to India's advantage to encourage an increased use of gold in the internal circulation.

(b) *Proposed Gold Mint for India.*

69. It will be convenient to deal at this point with the question of the opening of a mint for the coinage of gold in India. This proposal has been recommended on the ground that it would facilitate a flow of gold to India and that the mere fact of gold being coined in India would give confidence in the permanence and stability of the policy recommended by the Committee of 1898. Both these considerations have lost much of whatever weight they originally carried. Gold has flowed freely to India in recent years without this stimulus and we doubt whether any more could have been attracted by mere facilities for coinage.

70. Nor do we believe that the opening of such a mint would be of value at this date in winning public confidence in the stability of the exchange value of the rupee. This consideration had its force in 1899 and 1900, but the experience of 1907–8, the growth of the Gold Standard Reserve, and the whole trend of policy and opinion since 1898, leave no doubt as to the determination of the Government to maintain exchange, and in so far as confidence in their power to do so is lacking, it must be secured by measures which will make a real and not merely an imaginary addition to the resources available for this purpose.

71. More recently the idea of a gold mint has been pressed on the ground that it would increase the amount of gold in circulation. Even if we thought this in itself desirable, we are unable to follow the supposed connection between the end in view and the means recommended for securing it. The people of India can obtain under present conditions as much gold as they desire for currency purposes. Indeed the more usual difficulty is that gold coin is in greater abundance in the Reserves than is required for internal circulation. But even if this were not so, the mere existence of a mint for the coinage of gold could not add to the amount of gold available for currency purposes, and the idea that such a mint would give India an "automatic" currency, in any sense which is not true of the existing power to import sovereigns at will, appears to us to be wholly without foundation.

72. Nor is it likely that the facilities for converting gold bullion into coin which such a mint would provide would have any appreciable effect on the amount of gold withdrawn from circulation or would encourage gold to come out of hoards in unfavourable seasons. It is quite true that at times of famine and distress gold must come out of hoards, but we see no reason for believing that the amount so forthcoming would be increased by the opening of a mint for gold. The public in any case would secure equal advantages if the Government of India were to renew the notification, withdrawn in 1906, of their readiness to receive refined gold at the Bombay Mint in exchange for notes or rupees.

73. In our opinion, if this were done, it would remove the only practical grievance which can be alleged against the present system in this respect and would render wholly unnecessary the opening of a mint for the coinage of gold. We recognise however that there is in some quarters a strong, though a by-no-

means unanimous wish, that such an opening should take place. The authority of the Committee of 1898 can be cited in its support and there is said to be a strong sentiment in its favour. We find it difficult to judge accurately of the depth and extent of this feeling. For the reasons already given we do not ourselves share it and we cannot recommend on its merits the establishment of a gold mint in India. But if Indian sentiment genuinely demands it, and the Government of India are prepared to incur the expense, there is, in our opinion, no objection in principle either from the Indian or the Imperial standpoint, provided always that the coin to be minted is the sovereign (or the half-sovereign); and it is pre-eminently a question in which Indian sentiment should prevail. If, however, the final decision be against the opening of a gold mint, we recommend that the notification of the Government's readiness to receive refined gold at the Bombay mint should be renewed on suitable terms.

(c) *Conclusions.*

74. We have already stated that it is not to India's interest that further efforts should be made to encourage the circulation of gold as currency. We regard gold in circulation as wasteful, and we think that India should be encouraged to develop economical habits in matters of currency. In dealing with the paper currency system of India we shall make some suggestions in this direction, and any improvements in the banking facilities of India which tend to discourage the wasteful habit of hoarding the precious metals will be of great value to India. But while educating the people in the use of more economical forms of currency, it is important that the Government should continue to act on the principle of giving the people the form of currency for which they ask. We recognise that for many years to come a metallic currency will be the only suitable one for the vast majority of transactions in India, where over 90 per cent. of the people are illiterate and cannot be expected to use paper notes or cheques to any considerable extent.

75. There will still be opportunities for the use of gold coins rather than rupees in circumstances in which notes are not suitable and rupees are inconveniently cumbrous, and there will necessarily remain for a long period a considerable demand for gold coins for hoards of all kinds until the habit of banking takes the place of the hoarding habit as a means of securing and increasing savings. The line between gold in hoards and in circulation is an indefinable one, and the hoarding habit is sanctioned by the experience of centuries in India and by religious and racial laws and customs, with which the Government of India have neither inclination nor power to interfere. Any attempt to refuse gold to meet these legitimate demands would be unjust and foredoomed to failure, and could only cause alarm and instability. The proper line of advance consists not in actively discouraging the use of gold for currency but in encouraging the use of notes.

76. To sum up, our view is that India neither demands nor requires gold coins to any considerable extent for purposes of circulation (as opposed to saving or hoarding), that the most generally suitable media of internal circulation in India are at present rupees and notes, and that the Government should, as opportunity may offer, encourage notes, while providing—and this is the cardinal feature of the whole system—absolute security for the convertibility into sterling of so much of the internal currency as may at any moment be required for the settlement of India's external obligations.

(4) Gold Standard Reserve.

77. What then are the sterling resources of India for providing for the payment of India's external obligations? These resources consist of the Gold Standard Reserve, of the part of the Paper Currency Reserve held in gold or sterling securities, and of the India Office balance. This balance is, however, in normal conditions not more than is needed for working purposes, and may, therefore, be disregarded in any review of the resources permanently available to support exchange in a time of crisis.

78. We have already given a summary of the development of the Gold Standard Reserve since the date of its first inception. The principal criticisms directed against it as at present administered are to the location of the greater part of it in London, to its amount, to its composition, and in particular to the presence in a fund formerly designated the Gold Reserve and now the Gold Standard Reserve of a considerable sum in silver.

79. The experience of 1907–8 makes it clear that the Reserve is required not merely to meet the "home charges" of the Government of India at a time when an

adverse rate of exchange prevents the free sale of Council drafts, but also to liquidate an unfavourable balance of trade to the extent necessary to prevent exchange from falling below specie point. On the other hand, the Reserve is not required to provide for the conversion into sovereigns of the rupees in circulation in India. Gold is world's money, and India, like other great countries, needs gold less for internal circulation than for the settlement of external obligations when the balance of trade is insufficient to meet them. That being so, the aggregate amount of rupees in circulation has only an indirect bearing on the question of the Gold Standard Reserve. It is true that the Reserve is built up out of the profits on the coinage of rupees, but its object is not to secure the convertibility on demand of the whole of the rupees in circulation but only to provide a reserve sufficient to convert into sterling such amount of rupees as may at any moment seek export; in other words, such amount as the owners require to exchange for sterling in order to settle debts due in sterling.

80. This being the purpose of the Reserve, its amount depends not so much upon the amount of rupees at any time in circulation as upon the growth of India's trade and the extent of the deficiency which adverse seasons or circumstances may at any time be reasonably expected to produce in the country's power to liquidate immediately its foreign obligations.

81. The total amount up to which the Reserve should be accumulated has been a much canvassed question from the first. Our view that the amount depends upon India's trade balance implies that there is no need to accumulate the Reserve beyond the point at which it will be sufficient together with other sterling resources to meet all reasonably probable requirements in a time of adverse trade. But this point is not capable of exact definition. As trade expands and wealth increases in India imports will expand as well as exports. But the larger the total volume of the trade the larger is the amount (though not necessarily or even probably the proportion) of the possible variation from year to year in the net balance in favour of or against India. If the habit of private investment in sterling securities were to assume considerable proportions, and if India had already invested largely in such securities, the consequent possession of large sterling assets by the public in India would in itself act as a reserve for the support of exchange.

82. But for the present the growth of trade and industry carries with it a continual increase in the possible demands on the reserve fund in adverse times. One of the most noticeable features in the crisis of 1907–8 was the fact that for some time after the crisis had declared itself imports from abroad, ordered in advance in times of prosperity, continued to pour into India, thus accentuating the adverse conditions resulting from the failure of the crops and the consequent falling off in the volume of the exports. This must always be the case, and the larger the trade the greater will be the adverse balance which by these circumstances may be created. The failure of the crops and the consequent reduction of exports are sudden in their origin and immediate in their effect. Exports fall at once, but imports continue to flow in under outstanding orders and cannot be checked till those orders are exhausted. In time the balance would restore itself, but in the meantime exchange would have collapsed. It is to maintain exchange in the interval before the balance of trade can right itself that the Reserve exists, and its resources must be sufficiently liquid to be used at once and sufficiently large to meet the most prolonged strain to which it may reasonably be anticipated that they might be exposed.

83. There is normally a very large net balance of trade in India's favour; but in the year from 1st November 1907 to 31st October 1908 the imports of merchandise, including gold and silver, exceeded the net exports by 1,190,000*l*. (*see* Appendix IV., p. 108). Such an occurrence in the case of India, with an expenditure of 20,000,000*l*. a year on revenue account, apart from capital outlays, to meet in London, indicates the necessity for a very large sterling reserve, and the fact that this net excess of imports over exports of 1907–8 followed on a net balance in India's favour of 31,010,000*l*. in the corresponding twelve months of 1906–7 shows the enormous extent of the fluctuations to which India's trade is liable. The fact that in this particular instance the balance was righted by the issue of gold (or sterling assets) to the extent of 18,000,000*l*. in London and India combined cannot be taken as a measure of the amount which might be required under different circumstances and with a larger trade.

84. The crisis in question was undoubtedly a severe one. Its main features were a failure of the summer monsoon and a partial famine, coincident with a world-wide financial crisis. But the famine was not the worst experienced in India, the failure of the monsoon was for one season only, and the storm centre of the world-wide

crisis was in New York and not in London. It is impossible therefore to take the crisis of 1907–8 as a measure of the maximum demand on the Reserve. A second failure of the monsoon in the following year would undoubtedly have added to the burden, even though the check upon imports and the effect upon prices resulting from the previous year's crisis would have done something to mitigate its evil consequences, whilst, if the storm centre of the crisis had been in London, the difficulty of realising large quantities of the securities in which the Reserve was then held might have been considerable.

85. We do not accept, therefore, the figure of 18,000,000*l.*, which was the measure of the demand made by the crisis of 1907–8 upon the sterling reserves of the Indian Government, as an adequate guide to the amount which may be required in a similar crisis in future. Experience of a second period of adverse exchange is necessary before it will be safe to prescribe with any degree of precision the proper magnitude of the aggregate sterling reserves.

86. There remains the question what part of the burden of supporting exchange ought to fall on the Gold Standard Reserve and what part on the gold in the Paper Currency Reserve. It is the declared intention of the authorities at present to increase the Gold Standard Reserve up to a total of 25,000,000*l.*, and then to reconsider the necessity of continuing to appropriate to it the whole of the income from its present sources of supply. Of the Paper Currency Reserve the gold earmarked in London (at present 6,100,000*l.*) is commonly regarded as a far more reliable support to exchange than the gold held in India, and as the part of which account ought primarily to be taken. We incline to the view that reliance ought to be placed on gold in the Paper Currency Reserve for the support of exchange only in so far and so long as the Gold Standard Reserve is not yet adequate to support the burden by itself. There is no great likelihood of this in the immediate future and we do not think, therefore, that it would be useful for us to attempt to lay down at present any hypothetical limit beyond which additions to the Gold Standard Reserve should cease. We are accordingly of opinion that, even after allowance is made for the earmarked gold in the Paper Currency Reserve, the suggested total of 25,000,000*l.* is insufficient.

87. Our unwillingness to set a limit to the accumulation of the Gold Standard Reserve, so far as this is due to profits on the coinage of rupees, is increased by the fact that otherwise Government may appear to lay themselves open to the charge that they can (if foreign exchanges be left out of consideration) provide themselves with as much money as they like for internal expenditure by the simple process of coining rupees without limit. We do not suggest that it is even conceivable that the Government of India would actually take this suicidal course. But at the same time it appears to us undesirable that any Government should be open to attack in this way if it is possible to avoid it.

88. And here it may be well to notice the suggestion made by one witness that the Gold Standard Reserve has been built up by means of great sacrifices on the part of the revenues of India. The word "sacrifices" appears to us to be out of place in this connection. In building up the Reserve India has not sacrificed revenue. The most that can be said is that revenue has not been artificially swollen by the appropriation in aid of ordinary expenditure of certain funds which were rightly and necessarily devoted to a special purpose.

89. While, therefore, looking beyond the immediate future, we hold that the Government of India ought to be alive to the possibility of the aggregate sterling reserves eventually reaching an unnecessarily high figure, we recommend that the whole profits of the silver coinage, together with any interest accruing from investments or loans made from the Gold Standard Reserve, should for the present continue to be placed to the credit of that Reserve, and that no diversion similar to that made in 1907 for railway development should be under any circumstances permitted until further experience allows of a much more accurate definition of the calls which the Reserve may have to meet than is at present possible.

90. The most suitable place for the location of the Gold Standard Reserve is, in our opinion, undoubtedly London, and in this view the majority of our witnesses concurred. London is the clearing-house of the world, India's chief customer is the United Kingdom, and London is the place where money is required both for the expenditure of the Secretary of State on India's behalf and for payment of India's commercial obligations to this country and the world in general. If the Reserve

were kept in India it would have to be shipped to London to be used. This would involve delay at a moment when immediate action is essential. The objections put forward to keeping it in London rest on the belief that the Reserve is regarded in London as being available to supplement the Bank of England's reserve. There is no foundation at all for this belief. We have no hesitation therefore in recommending that the whole of the Gold Standard Reserve should be kept in London.

91. It remains to consider the composition of the Gold Standard Reserve. We have already mentioned the fact that until recently the whole of the London portion of the Reserve was kept in securities, and none in gold. Circumstances have profoundly changed since 1899 when the Indian Currency Committee were able to speak naturally of keeping a reserve in gold without proceeding to consider whether "gold" meant sterling securities or actual gold. At that time it scarcely occurred to anyone to distinguish between Consols and cash. The crisis of 1907–8 resulted in the sale of a large part of the Consols and similar securities held on account of the Reserve. It was fortunate that these securities were disposed of with little difficulty and without greatly reducing their market price. It may be regarded as a further piece of good fortune that it was necessary to dispose of these securities at that date and that the fund was therefore not affected by the further depreciation in their capital value which has since occurred. Larger quantities of short-dated securities less liable to capital depreciation were acquired when the Gold Standard Reserve again accumulated, and the cost price of the Consols and similar securities actually held on the 31st March 1913 was only 5,886,280*l.* out of investments the cost of which was 16,906,561*l.* in all.

92. The Secretary of State had so far yielded at the latter date to the arguments of the Government of India as to hold 1,005,664*l.* in loans at short notice, and a sum of 1,620,000*l.* in gold earmarked at the Bank of England, this latter sum being the beginnings of a total sum of 5,000,000*l.* which he is gradually accumulating in this form.

93. We are of opinion that the actual gold held in the Gold Standard Reserve should stand at a much higher figure than 5,000,000*l.* In the existing circumstances of the London money market even the finest securities such as Consols can no longer be regarded as identical with cash in the sense in which they were so regarded fifteen or twenty years ago, and their realisation might involve such a loss in capital value and such an aggravation of a crisis which it would be India's direct interest to allay, as to make the holding of more than a comparatively moderate proportion of such stocks undesirable in the case of the Gold Standard Reserve. Short term securities such as Treasury bills, Exchequer bonds, and similar securities have this advantage over Consols that the chance of any big loss of capital on realisation is less; but these securities may not be always realisable in large amounts quite so quickly or readily as Consols, and their enforced realisation at a particular moment might, under certain circumstances, so aggravate an adverse situation in London as to increase India's difficulties and to injure Indian interests. In so far as such securities as Consols continue to be held in the Gold Standard Reserve, we would call the attention of the authorities to the consideration that to obtain an advance against such securities by pledging them might in some cases be a preferable alternative to selling them outright, since it might be possible to raise money in this way after it had become difficult to sell except at a very serious loss.

94. In any case, the realisation in a crisis of securities in large quantities, and even the calling in of sums lent out at short notice, are likely to cause some stringency in the London market, and if the exchange crisis in India which makes such realisation necessary is accompanied or directly caused by a financial crisis in London or reacting upon London, as is very probable, the difficulty of realisation may be accentuated, and the possibility of loss to India cannot be ignored. India should, in this respect, be as far as possible independent of London. Just as London must look to its own resources in such a crisis, and does not and cannot count on help from Indian reserves, so India should be in a position to defend its own financial position without undue recourse to the gold reserves of London. The Gold Standard Reserve is built up out of the fruits of the economy of gold. It is a necessary condition of such economy that an adequate reserve should be held against an exchange crisis, and it is right that such reserve should be sufficient in itself to meet the crisis and should not be dependent on conditions which India cannot control or on resources accumulated by another country to meet its own liabilities.

95. What then is the amount of actual gold which should be held on account of the Gold Standard Reserve? We do not think that it is possible to fix an amount which will hold good for all time. The amount of actual gold depends like the aggregate of the whole fund on a consideration of conditions which are constantly changing. We see no necessity for keeping the whole fund in gold, as is sometimes demanded. To do so would be, in our opinion, unnecessary and wasteful, and would take away from the Reserve an important source of future increase. On the other hand, we are clearly of opinion that the actual holding of gold in this Reserve has been and is insufficient, and that it is important to take immediate steps for its increase.

96. In our opinion, the best rule in present circumstances would be that not less than one-half of the fund should be held in actual gold when the total fund exceeds 30,000,000*l*., and that a minimum amount of 15,000,000*l*. should be accumulated as rapidly as possible. If this rule is followed and a sum of not less than 5,000,000*l*. is usually kept in gold in London as a part of the Paper Currency Reserve, it will be possible for India in a time of exchange crisis to release in actual gold an amount equal to the amount of securities which it may be desired to realise, and at the same time to have a final reserve of gold left. So soon as circumstances render recourse to the Gold Standard Reserve necessary, the policy of the authorities should be to use both the securities and the gold, advantage being taken of the release of gold to facilitate the realisation of securities.

97. Taking the figures at the 31st March 1913, the total amount of the Gold Standard Reserve was:—

	£	£
Securities at market value - - - -	15,945,669	
Money lent at short notice - - - -	1,005,664	
		16,951,333
Gold deposited at the Bank of England - - - -		1,620,000
		18,571,333
Silver in Indian Branch: 6 crores at 1*s*. 4*d*. - - -		4,000,000
		22,571,333

98. The holding of silver in the Gold Standard Reserve has given rise to much criticism, and is responsible for much confusion and doubt as to the efficiency of the Reserve. If the proposals which we make in a later section in regard to the Paper Currency Reserve are carried out, it will be possible to exchange at once the 6 crores of silver for 4,000,000*l*. of gold, and we recommend that this should be done. Further, the Paper Currency Reserve will be able to take over from the Gold Standard Reserve at least 4,000,000*l*. of its securities in exchange for gold.

99. These transactions will at once raise the total amount of gold in the Gold Standard Reserve from 1,620,000*l*. to 9,620,000*l*. This figure is still much below the proportion suggested by us.* It should be further increased as opportunity offers for the revision of existing investments as well as by the addition of new money.

100. The gold transferred from the Paper Currency Reserve in India might continue to be held there for a time as part of the Gold Standard Reserve, but, as we are of opinion that London is the proper place for the Gold Standard Reserve, steps should be taken to transfer it to London as soon as convenient.

101. We have considered whether it would be desirable to make the Gold Standard Reserve the subject of statutory regulations. But there are disadvantages in restricting the freedom of Government in a crisis, and it is undesirable that the disposition and amount of the Reserve should be stereotyped until further experience makes it possible to forecast with greater certainty the nature and the extent of the calls which may be made upon it. We therefore do not recommend that the Gold Standard Reserve should be regulated by statute. But we advise that the Government should make a public notification of their intention to sell bills in India on London at the rate of 1*s*. $3\frac{29}{32}$*d*. whenever they are asked to do so (as was actually done in 1908, and confirmed in 1909), to the full extent of their resources. We believe that the knowledge that such exchange can be purchased at any time will do much by itself to inspire confidence, and so to reduce the actual demand for drafts on London, and to prevent that feeling of panic which is liable to accompany and to aggravate periods of financial strain. With the Reserve for the support of

* The figure 1,620,000*l*. is that of the gold held on the 31st March 1913. Considerable additions have been made to this total quite recently, while this Report has been under discussion.

exchange so strong as it will, we hope, prove if our recommendations are accepted, we do not think that there is any reason to fear that in undertaking this liability the Government of India would be in any danger of being unable to carry out their obligations.

(5) Paper Currency.

102. The Government Paper Currency System of India dates from 1862, in which year the previously existing notes of the Presidency Banks, which had only a restricted circulation, were withdrawn, and a Government monopoly of Note issue was established. The notes are in the form of promissory notes of the Government of India, payable in rupees to bearer on demand, and are issued in denominations of 5, 10, 50, 100, 500, 1,000, and 10,000 rupees. They are issued without limit at any paper currency office against rupees or gold. For the purpose of the note system, India is divided into certain circles, and (with the exception of the 5-rupee note which was universalised outside Burma in 1903) the notes were, until 1910, legal tender only within the circle of issue, and could be encashed as of right only at the head office of the circle of issue. In 1910 power was taken to make the notes universal legal tender throughout India and encashable as of right at the head offices of each of the circles, now seven in number, and under this power all the smaller denominations of notes up to and including those for 100 rupees have been universalised. Extra-legal facilities for encashment are given at most of the Government treasuries, and, in practice, notes are freely encashed there within reasonable limits. The growth of the gross circulation was slow. From 3·69 crores in 1862 it had reached only 15·77 crores in 1890. After that date the increase was more rapid, and of late years, especially since the partial abolition of the circle system, the circulation has expanded very fast. The figures are (in crores of rupees):—

Average of Year.	Gross Circulation.	Notes held in Reserve Treasuries.	Net Circulation.	Notes held in Government Treasuries other than Reserve Treasuries.	Notes held in Presidency Bank Head Offices.	Active Circulation.
1900–1 - - - -	28·88	2·34	26·54	1·81	2·68	22·05
1906–7 - - - -	45·14	3·66	41·48	1·99	5·56	33·93
1911–2 - - - -	57·37	5·53	51·83	2·34	7·60	41·89
1912–3 - - - -	65·62	10·71	54·92	2·52	7·01	45·39

103. The Indian system of note issue was avowedly modelled on that of the Bank of England as regulated by the Bank Charter Act of 1844, and in its main features remains unaltered to this day. It was provided in 1862 that a metallic reserve should be kept against the whole of the notes issued with the exception of such amount not exceeding 4 crores of rupees as might be fixed by the Governor-General in Council with the consent of the Secretary of State. This amount was to be invested in Government securities The amount of the Reserve that may be invested has been increased by special Acts from time to time to 14 crores, of which a maximum of 4 crores may be held in sterling securities. The composition of the Reserve on the 31st March 1913 was as follows:—

Total Circulation.	Silver in India.	Gold in India.	Gold in London.	Securities.	
				Sterling.	Rupee.
	Crores.	Crores.	Crores.	Crores.	Crores.
68·97 crores.	16·45	29·37	9·15	4·00	10·00

It will be seen that the securities now amount to a little over 20 per cent. of the total reserve. In spite of an addition of two crores to the securities in 1911, this is a much lower percentage than was usual in earlier years, the figures at the end of each year in which the successive additions to the securities have been made being—1871–2, 44·9 per cent.; 1890–1, 27·2 per cent.; 1896–7, 42·1 per cent.; 1905–6, 26·9 per cent.; 1911–2, 22·8 per cent.

104. In this country the intention of the framers of the Bank Charter Act of 1844 was to prevent the abuses attendant on the issue of notes without the backing of a metallic reserve by securing the retention in reserve of coin against every single note issued over and above a maximum amount which was allowed to be covered by securities. This system was for long believed to be the ideal of a note issue system. But in fact its result has been to reduce notes to a very insignificant position in the British Currency system. The complete inelasticity imposed by the Act of 1844 upon the currency of notes, an inelasticity which can only be modified temporarily and as a last resort by the extra-legal power assumed by Government of suspending the Bank

Charter Act in a crisis, has only been tolerated because of the discovery in the cheque system of an alternative means of obtaining an elastic paper currency, which could not be obtained through the note issue under the terms of the Act. The main paper currency of the United Kingdom now consists of cheques, and the gold reserve of the Bank of England, though nominally supporting a comparatively small note issue, is really the ultimate support of a gigantic currency of cheques and other credit instruments of which the notes of the Bank of England form only a small portion.

105. In India, at all events outside the Presidency towns, conditions have not as yet favoured any great extension of the cheque system or of credit instruments generally, and metallic currency and notes of small denominations remain the favourite and the only suitable currency medium with the vast majority of the public. But since the closing of the Mints to silver in 1893, the expansion in the trade and commerce of India has made the need for a more elastic currency increasingly felt, and the restrictions imposed upon the note issue system by the requirement of a metallic backing for all notes issued above a fixed maximum, which can only be altered by a specific Act of the legislature, have become increasingly inconvenient. Some elasticity has, it is true, been introduced, rather incidentally than intentionally, by the Gold Note Act of 1898 and the development of the system of sales of Council Drafts already referred to (para. 24), under which it has become possible for notes to be issued in India against money tendered to the Secretary of State in London. But so far as the Paper Currency system itself is concerned this elasticity is secured only by the earmarking of gold in London, which is equivalent to the export of gold from London to India; the expansion of the currency of India is thus at the expense of the gold reserves of London, and in some circumstances the resulting stringency in London is so disadvantageous to India as to make an expansion of the currency by this means actually undesirable.

106. Before considering the possibility and desirability of adding elasticity to the note issue system we must first examine, more particularly, the present location and disposition of the Paper Currency Reserve.

In our summary of events relating to the exchange value of the rupee we have explained how it came about that this Reserve was made a part of the machinery for receiving gold, both in India and in London, in exchange for rupees, for holding in India gold intended to be passed into circulation, and for acting "as a first line of defence," as it has been called, for the 1*s*. 4*d*. parity of the rupee. While the main object of the Reserve is to secure the absolute convertibility of the notes, the location of the Reserve and the proportion between the gold and silver in the metallic portion now depend on other considerations as well.

107. The holder of a note is entitled to receive payment for it in Indian legal tender money, that is in sovereigns, half-sovereigns, or rupees. As he usually prefers rupees and has a right to demand them, the first necessity is that sufficient rupees should be held in the Reserve to meet this demand. To meet demands from this and other causes during the busy season the Government consider that the stock of rupees in reserve should not be allowed to fall below 24 crores on the 1st November in any year, or 18 crores on the 1st May in a year of active trade (*see* question 9099). These figures have been evolved on the basis of experience and are periodically reconsidered. As six crores are at present held in the Gold Standard Reserve the minimum figures for the Paper Currency Reserve are 12 crores on the 1st May, and 18 crores on the 1st November. If the outflow during the busy season is so great as to threaten a reduction below 12 crores on the 1st May, or the inflow during the slack season is insufficient to build up a total of 18 crores on the 1st November, steps are taken to coin fresh rupees.

108. The total amount of gold in the Paper Currency Reserve naturally fluctuates inversely with the total stock of rupees in the same Reserve. When the rupees threaten to fall short, the gold accumulates, and it is by using the excess gold that the cost of silver for fresh coinage is eventually met. As already explained, the authorities endeavour, through the sale of Council Drafts in London, to secure that the gold should not accumulate in India to such an extent as to involve shipment back to London. In practice the amount of gold accumulated in India has, except when depleted by the exchange crisis of 1907–8, always tended to exceed the maximum demand for gold from the Reserve in India. The policy pursued in quite recent years has been to locate from about five to seven millions sterling in London, and only to secure the presence in London of further gold belonging to this Reserve when the money is wanted to purchase silver. This policy has been criticised by some of the witnesses who appeared before us. It seems to us, however, to be at present justified by two considerations. In the first place it is reasonable that for the purchase of silver some part of the Paper Currency Reserve

gold should be kept in London, as the principal source of supply: for this purpose no great amount is required. But, second, there is the maintenance of exchange to be considered. The facts are that the gold in the Reserve in India has been much in excess of the demand, that the Gold Standard Reserve has not in itself been sufficient to secure beyond question the stability of exchange, and that gold in London is more directly and indubitably effective for this purpose than gold in India. In these circumstances, so long as the Gold Standard Reserve is insufficient by itself for the support of exchange, we think the policy is justified.

109. The present maximum for the securities in the Reserve is, as already stated, 14 crores. Until 1905 the whole of the securities held consisted of rupee paper, but the additions of two crores in 1905 and two crores in 1911 have taken the form of investments in sterling securities. This extension of the area of investment was made, partly with the object of not having too large holdings of a security which was likely to be depreciated by the same causes as would possibly entail a run on the Paper Currency Reserve involving their sale, and partly as an additional sterling support for exchange.

110. We are of opinion that considerable improvements can be made in the location and disposition of the Paper Currency Reserve.

In the course of our inquiry the suggestion has frequently come up for consideration that the Gold Standard and Paper Currency Reserves should be amalgamated. The overlapping which occurs between the functions of the two Reserves makes this suggestion attractive, and it is possible that an amalgamation may be found desirable in the future. But for the present we think that the balance of advantage lies in the maintenance of two separate Reserves.

A very conservative treatment of the Gold Standard Reserve may, however, in certain circumstances strengthen the position of the Paper Currency Reserve. A drain on the Gold Standard Reserve for the support of exchange alters, not its volume, but only its form; and when rupees have accumulated in this Reserve, as a result of providing gold for payments abroad, these rupees are available, if necessary, for transfer to the Paper Currency Reserve in exchange for sterling securities. Such a transfer would be financially sound from the point of view of both Reserves; and, provided that the rupees were only issued from the Paper Currency Reserve in exchange for notes previously circulating, the total reduction of currency would be no less than before. In the consideration of the Paper Currency Reserve, therefore, the increase of strength which would accrue to the Gold Standard Reserve, if our proposals under that head are adopted, ought not to be entirely overlooked.

111. We have already recommended that the six crores of rupees in the Indian Branch of the Gold Standard Reserve should be handed over to the Paper Currency Reserve, which is the more natural place for keeping a reserve of rupees. The minimum figures of 24 crores on the 1st November and 18 crores on the 1st May for the stock of coined rupees in reserve will be unaffected, but in future this stock will be entirely within the Paper Currency Reserve. 4,000,000 sovereigns should concurrently be transferred from the Paper Currency Reserve in India to the Gold Standard Reserve.

112. Our next recommendation is that the fiduciary portion of the Paper Currency Reserve should be increased at once to 20 crores. But instead of merely fixing this figure as a maximum, we propose that the maximum of the fiduciary portion should be fixed at the amount of the notes held by the Government in the Reserve Treasuries *plus* one-third of the net* circulation for the time being. Under this proposal the invested portion of the Reserve will be at once increased by six crores. We recommend that this result should be effected by a transfer (at market value) of sterling securities to that amount from the Gold Standard Reserve in exchange for six crores of the gold now in the Paper Currency Reserve in India.

113. So long as the gross circulation exceeds 60 crores, it will be within the power of the authorities to increase the investments of the Reserve and we propose that the Government should have power not only to make such further permanent investments as they think fit but also to make temporary investments or to grant loans either in India or in London. In India such loans should be made to the Presidency Banks on the same terms as we propose hereafter in the case of loans from balances, while in London the Secretary of State should have power to lend out in the London market sums received in payment for Council Drafts sold against the Currency Reserve in the busy season so long as the total of the cash portion of the Reserve does not fall below two-thirds of the net circulation.

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* By net circulation we mean the gross circulation less the amount of notes held in the Reserve Treasuries, *cf.* para. 102.

114. We hope for the following advantages from our recommendations: (1) While the permanent addition to the invested portion of the Reserve will be no more than is justified by past practice and experience without in any way endangering the complete convertibility of the notes, the revenues of India will secure the profit earned by investing the amount now held idle in the form of gold in India. (2) There will be occasions, especially in the busy season, when it will be safe to lend temporarily sums which it would be unwise to invest permanently. The power to make such loans will, therefore, enable the Government to earn interest on sums which would otherwise lie idle needlessly, and will provide at the same time a much needed facility for a temporary expansion of the currency in the busy season, by virtue of which the market may obtain some relief, though not at first, perhaps, a very great amount, from its recurrent stringency. (3) The power to make temporary investments in London on account of the Paper Currency Reserve will be a convenience to the Secretary of State in permitting him to sell Council Drafts against the Paper Currency Reserve, in anticipation of silver purchases or of any other cause, without the loss of interest and other disadvantages which might sometimes come about if he were compelled, without discretionary power, to utilise the entire proceeds of such sales in earmarking gold. (4) As the circulation of notes in India increases, it will be within the power of the authorities to increase as and when desirable either the permanent or the temporary investments of the Reserve or both without a special Act. (5) The power to make loans from the cash held against notes in the Reserve Treasuries will provide the Government with a useful alternative or supplementary means of counteracting some of the disadvantages arising from the existing Reserve Treasury system with which we deal in the next section of our report.

115. We think it eminently desirable that the use of notes in India should be encouraged by all legitimate means. With this object in view, we recommend that the Government should increase, whenever and wherever possible, the number of places at which the notes are encashable as of right as well as the extra-legal facilities for encashment. We think it would be desirable to universalise at once the notes of 500 rupees. With the experience so gained it may be found possible to carry universalisation still higher. We do not think that the extra cost of remitting specie from place to place to provide for the encashment of notes would, except at the outset, be appreciable, and we think that, in any case, it would be more than counterbalanced by the advantage of an increased circulation of the notes as a medium of currency.

116. In accordance with our general view as to the position of gold in the internal currency of India, the gold remaining in the Paper Currency Reserve in India will be used for meeting demands in India just as at present. The Government will not undertake to supply gold in all circumstances, but should be ready in normal times to supply gold for internal purposes up to the full extent of the resources of the metallic portion of this Reserve. But, as soon as an exchange crisis declares itself in the form of an effective demand for bills on London at 1*s.* $3\frac{29}{32}$*d.*, any gold in the Paper Currency Reserve in India should be given out only on such conditions as will secure its immediate export.

117. The amount of gold held at any time on behalf of the Paper Currency Reserve in London will be regulated according to the conditions of the metallic reserve in India. When rupees are plentiful and the stock of gold correspondingly small in India, the Secretary of State will hold not more than the amount of 5,000,000*l.* which we have allowed for as the normal amount of actual gold likely to be available in London outside the Gold Standard Reserve in support of exchange. In a time of crisis this sum of 5,000,000*l.* should be treated, not as the first line of defence for the exchange, as it has sometimes been called, but as standing behind the Gold Standard Reserve, especially the gold portion of it, so far as exchange is concerned, while serving also the important function of acting, together with and in support of the sterling securities in the Paper Currency Reserve, as a final resource for securing the convertibility of the notes in an internal crisis in India. Any additions to the gold held on account of the Paper Currency Reserve in London over and above the sum of 5,000,000*l.* should be regarded as temporary only, and used as and when required for the purchase of silver for coinage into rupees, the function of such additional gold being to maintain the internal currency of India and not to support exchange.

118. The following tables show in parallel columns the position of the Gold Standard and Paper Currency Reserves on the 31st March 1913 and the position as it would have been on the assumption that our recommendations had been carried out at that date, and will explain at a glance the effect which our recommendations would have upon the location and disposition of the Gold Standard and Paper Currency Reserves.

Gold Standard Reserve at 31st March 1913.

	Market Value. £
Sterling:	
Securities not due for early redemption - - -	4,956,165
Securities due for early redemption - - -	10,989,504
Sums lent out at short notice - - - -	1,005,664
Total invested - -	16,951,333
Gold deposited at Bank of England - - -	1,620,000
Total in London -	18,571,333
Rupees in India:	
Rupees in reserve in India, 6 crores, equals - -	4,000,000
Grand Total - -	£22,571,333

Gold Standard Reserve as proposed by Commission.

	£
Securities not due for early redemption (say) - -	2,456,165
Securities due for early redemption (say) - -	9,489,504
Total invested - -	11,945,669
Gold - - - - - -	*10,625,664
Grand Total - -	£22,571,333

Of the gold the greater part would at first be held in India, but would be replaced as circumstances permitted by gold earmarked at the Bank of England.

Paper Currency Reserve at 31st March 1913.

	Crores.	Crores.
Rupees - - - - -		16·45
Gold in London - -	9·15	
„ in India - -	29·37	
		38·52
Securities at cost:		
In London - - -	4·00	
In India - - -	10·00	
		14·00
Gross circulation - - -		§68·97
Amount of Notes in Reserve Treasuries - - -		12·68
Net circulation -		56·29

Paper Currency Reserve as proposed by Commission.

	Crores.	Crores.
Rupees - - - - -		†22·45
Gold in London - -	9·15	
„ in India - -	‡17·37	
		26·52
Securities at cost:		
In London - -	†10·00	
In India - - -	10·00	
		20·00
		68·97

The maximum fiduciary portion being one-third of net circulation	=18·76	
plus Notes in Reserve Treasuries	=12·68	
		31·44
And the actual investments being - - - -		20·00
There was available for temporary investment or loans - -		11·44

Total Amount of Gold in London as at 31st March 1913 in Gold Standard and Paper Currency Reserves combined as proposed by Commission.

	£
In Gold Standard Reserve (assumed to be all in London) -	10,625,664
In Paper Currency Reserve (in London) - - - -	6,100,000
Total - - -	16,725,664

* Viz.:—

	£
Gold already held - - - -	1,620,000
Gold received for securities transferred - - - - - -	4,000,000
Gold received for rupees transferred - - - - - -	4,000,000
Gold realised by calling in short loans - - - - -	1,005,664
	£10,625,664

‡

	Crores.
Gold already held in India - -	29·37
Deduct—	
Transferred to Gold Standard Reserve in exchange for rupees and securities - - - -	12·00
	17·37

† 6 crores transferred from Gold Standard Reserve.

§ At this date the gross circulation was exceptionally large.

III.—BALANCES.

(1) Aggregate Balances.

119. We have now disposed of the questions of currency which we had to consider and pass to the second, or, as it may be called to distinguish it from what precedes, the financial branch of our inquiry. This has relation to the moneys of the State, and includes the amount and location of the Government balances as well as the method by which their distribution between London and India is arranged, that is to say, the system of Council Drafts.

120. In view of comparisons which are sometimes made between the total balances kept by India and by the Government of the United Kingdom, it is desirable to begin by drawing attention to the danger of basing arguments upon any such comparison. The general balances of the Government of India and the India Office balances do not correspond in any way to the Exchequer balance at the Bank of England as shown in the statement of revenue and expenditure published in the "London Gazette" of Tuesday in each week. They correspond more closely with the Government deposits as shown in the weekly statements of the Bank of England; but even here the comparison is inadequate, as the Indian Government's balances both in India and in London include considerable sums held on behalf of Indian railway companies, sums belonging to local and district boards for which the Government act as bankers, and many other items, for which no close parallel can be found among the items which go to make up the British Government's deposits at the Bank of England. The Indian total, also, includes large sums held as working balances at the various treasuries and sub-treasuries throughout India and Burma, as well as the balances at headquarters in India and in London, whereas, except for the small balance kept at the Bank of Ireland, the British Government keep practically only one working balance and that in one place only, viz., at the Bank of England. For all these reasons arguments founded on a comparison of the total balances of the two Governments must be used with great caution.

121. The next step in this part of our inquiry must be to determine the amount which it is essential for the Government to hold in London and in India respectively.

122. We are advised that the minimum working balance required in London is normally about 4,000,000*l.*, and looking to the large payments that fall due at the beginning of each quarter, we consider that this amount is not excessive. In India the standard balance is very much higher. The minimum balance, we have been told, with which the Government of India can work their transactions, is about 8,000,000*l.*; this minimum is reached normally in November or December; and, since between April and the end of the year there is a large net withdrawal from the Government treasuries, it is the practice to budget for an opening balance in each financial year of something over 12,000,000*l.*

123. This estimate of requirements is based on experience, and we have no reason to doubt its accuracy. It has naturally not been possible for us to examine in detail the working of the "Resource Operations" of the Government of India, that is, the machinery for keeping the various treasuries and sub-treasuries in India in funds, nor have we the knowledge required for undertaking such an examination. It is, however, clearly desirable that any Government should endeavour by all reasonable means to manage their collections of revenue and the amount of their balances from time to time in such a way as to cause as little inconvenience as possible to the money market. We therefore call attention to the importance of a periodic review by the Government of India of the amounts so held in order to secure all possible economy of balances and to take advantage of all fresh facilities for remittance which the growing development of communications and other modern improvements provide.

124. We have indicated that the normal figures for the closing balance each year are, in London 4,000,000*l.* and in India 12,000,000*l.*, making in all about 16,000,000*l.* Compared with these normal figures, the actual balances have been in recent years:—

	In London.	In India.	Aggregate.
	£	£	£
31st March 1908	- 4,607,266	12,851,413	17,458,679
„ 1909	- 7,983,898	10,235,483	18,219,381
„ 1910	- 12,799,094	12,295,428	25,074,522
„ 1911	- 16,696,990	13,566,922	30,263,912
„ 1912	- 18,390,013	12,279,689	30,669,702
„ 1913	- 8,783,970	19,293,131	28,077,101

125. The great excesses shown by these figures have naturally attracted attention, and in particular the very large balances which have been held in London have been the subject of much adverse comment. It will be clear, however, that the primary factor has been an excess in the aggregate of the Government moneys, which alone made it possible for the London balance to be so much above the normal. It is this factor, accordingly, that we propose first to examine, and we shall then proceed to deal with the distribution of the aggregate, and the location of a great part of it in London.

126. The first point to be noted is that the great rise in the balance as a whole has not been in accordance with the anticipations of the Government; on the contrary, each budget has provided for a reduction of balances to a figure not far removed from the normal, and each year the intentions of the budget have been defeated by an improvement in revenue or by a falling off in expenditure which were not foreseen at the time of its preparation. It would seem, therefore, that primarily the question is one of estimating, and we cannot but feel that in preparing their estimates of revenue the Government of India have erred on the side of caution. We are convinced, however, that, in the peculiar circumstances of India, this is an error on the right side, and that the consequences of too sanguine a forecast, perhaps committing the Government to premature expenditure beyond their real resources, and involving at any time the risk of a deficit, are much more serious than those which can arise from the occurrence of large surpluses. In the circumstances of such a country as India it is not safe to spend up to the hilt during a period of prosperity; there is everything to be said for a general policy of caution which utilises the increased resources of such a period to strengthen the financial position against the recurrence of bad seasons, and it is certain that the adoption of this policy in recent years has done much to secure Indian finance against vicissitudes in the immediate future. It is to be remembered also that in recent years the position of the opium trade, which hitherto has contributed largely to the Indian revenues, has been altogether exceptional. So uncertain in fact have been the prospects that recently the Government of India have deliberately estimated the receipts under this head at the figure which they were likely to reach under the least favourable circumstances, while specifically hypothecating in advance any surplus that might accrue over that figure to certain particular kinds of expenditure.

127. A further cause of the large figures reached by the aggregate balances has been the failure to spend up to the amount estimated on capital account. This feature is particularly noticeable in the year 1910–1, when over 3,000,000*l.* out of a total estimated outlay of 6,500,000*l.* in India remained unspent at the end of the year, and over 1,000,000*l.* was similarly left unspent in London out of a total of 6,250,000*l.* Much of the underspending is attributable to the Indian railway companies rather than to the Government authorities in London and India. Several witnesses have drawn attention to the general question of Indian railway finance, and have urged the importance of a settled programme of railway development, providing for three or four years in advance. The adoption of such a plan, if properly followed up in other respects, should undoubtedly reduce the underspending, but except in this connection this subject has appeared to us to fall outside the scope of our reference. Whatever the ultimate reason for this underspending may be, it is an important contributory cause to the size of the balance, because the probability of underspendings only becomes known late in the financial year, whereas the borrowings of the India Office to meet such expenditure have usually taken place some time earlier.

128. In the circumstances of the case we recognise that cautious estimating was in the main justifiable, though it was carried rather further than was necessary.

Even under normal conditions we have been much impressed by the difficulties of preparing a budget in India. The revenues of India, whether shown under railways or customs or directly under the head of land revenue, fluctuate to an extraordinary extent with the success or failure of the agricultural operations of each year, and these again depend predominantly on the south-west monsoon which spreads over the Indian continent and Burma in the months of June to October. Under present arrangements the Indian budget is presented before the end of March, and the Finance Minister accordingly has to prepare his estimates in ignorance of the most important factor on which the results of the year will depend. The late Finance Member of the Viceroy's Council, indeed, has described the framing of a budget as a gamble in rain. We would observe, however, that the description applies only because the budget is taken before the monsoon. It is clear in fact that from the financial point of view the present date is almost the most inconvenient possible for the budget, and the suggestion has therefore been made that the date of the beginning of the financial year should be altered from the 1st April to the 1st November or 1st January. There may be administrative difficulties in carrying this suggestion into effect, but, financially, it would be a great improvement. Criticism directed against the inaccuracy of Indian budgetting is not effectively answered by a reference to the difficulties which arise under present conditions. It has to be shown further that these difficulties cannot be removed by a change of date without incurring graver disadvantages, and we commend the question to the consideration of the Government.

129. When the excess of the aggregate balances is mentioned, however, the criticism which we have elicited from witnesses has been directed, not so much against the inaccuracy of recent budget estimates, as against the continuance of taxation which, it is alleged, was in fact unnecessary. With this second criticism we have in the circumstances no sympathy. If the budget anticipations had been more in accordance with results, it is true that they would have shown much larger surpluses, and they might have suggested the possibility of a reduction of taxation. But there are peculiarly strong reasons in India against temporary alterations in the scale of taxation, and it is clear that the finances of the country were faced in the near future by two circumstances, first the disappearance of the opium revenue, and second the inception of a large programme of new expenditure particularly on education and sanitation, which made it extremely improbable that a reduction of taxation, if sanctioned, could be maintained for any length of time. In the circumstances it was clearly better to follow the policy which was in fact adopted of making use of the additional resources provided by a period of prosperity, not for the reduction of taxation, but for the general strengthening of the financial position.

(2) Location of Balances.

130. We now pass to the question of the location of balances, a subject which has aroused much criticism. Government money, it is said, has been moved unnecessarily from India where it would have assisted business, and the London money market has had an accession to its resources at the expense of the country to which the money primarily belonged. To the extent of the normal working balances the location of Government funds has already been determined, and it is only the excess over these amounts which has now to be considered. With regard to this excess there are two principles to be observed. The first is that it is undesirable financially that a Government should borrow with one hand and lend with another; so that the first object to which any surplus should be applied is the reduction or avoidance of debt. The second principle is concerned with the relations of Government to the trader and the general taxpayer. It is implicit in the criticisms we have noticed that it was the duty of Government to help trade in India, but it is not clear whether in the opinion of the critics this should have been done even if it resulted in a loss of revenue in the shape of interest or in some other form detrimental to the general welfare represented by Government. On this point there can be no doubt that it is the general welfare that has to be preferred. It may be admitted that the Government should in money matters adapt themselves as far as possible to the requirements of trade, but they must clearly subordinate the interests of particular classes to the welfare and security of the whole.

131. We will endeavour to apply these principles to the recent conditions of India. If there is a debt outstanding which can be paid off, London is the place where a surplus balance should be located. The same considerations apply if avoidance be

substituted for reduction of debt. As far as the ultimate object is concerned, therefore, to which a surplus balance should be applied, we hold that it must come to London. So far, we understand, the critics of Government would agree, but they add that the balances were transferred to London prematurely and in advance of requirements. Granting then that the final application of surplus balances was satisfactory, the question which arises is one of their intermediate investment. This, on the second principle indicated by us, would appear to depend primarily upon the relative security and rate of interest obtainable in India and in London respectively; in other words, if the security were as good and the rate were as high in India, the Government would be well advised to keep their surplus money there; but, if the security were better or there were a prospect of earning more in the London money market, they should transfer their funds to this country.

132. In the circumstances of India, however, these are not the only factors to be considered. The surplus balances now under consideration naturally arise in periods of prosperity, when not only the revenues of the Government but the claims of India against other countries are expanding, and exchange is high. It is natural that the Government should take advantage of these conditions to transfer their money to London at a favourable rate of exchange, and the possibility of a loss in exchange if they defer action has always to be set against any advantage they may gain meanwhile by lending out their money in India at a higher rate of interest. Whether, therefore, we are considering the final or the intermediate employment of any surplus balance, it will be seen that strong reasons exist for transferring it to England.

133. We find no fault, therefore, with the course taken by Government in recent years, for, under the conditions hitherto laid down for loans in India, there was no effective demand for such loans and no use for the money in that country. If, however, the recommendations which we make as regards loans in India be approved, there will be new opportunities for the temporary use of a portion of this money in India, and the occasions, though not the extent, of transfer may have to be revised accordingly.

(3) Indian Balances.

134. We now proceed to an examination of the balances held in India. The balances of the Government of India in India are divided between the district treasuries and sub-treasuries, the branches of the Presidency banks, the head offices of those banks at Calcutta, Bombay, and Madras, and the Reserve Treasuries at these three places. The following figures showing the distribution on the 31st March 1912 illustrate the normal position of these balances at the close of the financial year:—

	£
In 270 district treasuries (including some 1,500 sub-treasuries)	5,790,700
In 36 branches of the Presidency banks - - - - -	1,580,500
At the three head offices of the Presidency banks - - -	1,402,500
At the three Reserve Treasuries - - - - - - -	3,506,000
Total - - -	£12,279,700

135. Certain fixed minimum sums are kept at the head offices of the Presidency banks under agreement with the Government, viz.:—

	£
At the Calcutta office of the Bank of Bengal - - - - -	233,300
At the Bombay office of the Bank of Bombay - - -	133,300
At the Madras office of the Bank of Madras - - - - -	120,000
	£486,600

These minima may be regarded as (speaking generally) part of the remuneration to the banks for work done for Government and compensation for the loss in 1862 of the privilege of issuing notes. In practice the Government of India keep considerably larger sums at these head offices, viz.:—

At Calcutta, 467,000*l.* to 533,000*l.*
At Bombay, 267,000*l.* to 333,000*l.*
At Madras, a little over 133,000*l.*

136. Branches of the Presidency banks are regularly used for the keeping of the Treasury balances in the comparatively few places where such branches exist, and the Government have made a practice of late years of offering to guarantee a fixed minimum balance for a period of five years as an inducement to the banks to open new branches and take over the district treasuries in the places where such branches are opened. But, except in places where such a guarantee is in operation, Government balances at the branches of the banks seldom exceed immediate requirements to any considerable extent, the Government's policy being, as a general rule, to draw any surplus balances to certain centrally situated treasuries and finally to the Reserve Treasuries. The balances at the head offices of the Presidency banks are not allowed to exceed certain fairly well-defined maxima, except temporarily and for special reasons. Thus, in practice, whatever surplus Government balances there may be in India at any time tend to be accumulated in the Reserve Treasuries.

137. The independent Treasury system is not an ideal one, and compares unfavourably with the practice prevailing in the United Kingdom and in most other countries of keeping Government balances at a bank. In the United Kingdom, as in India, a considerable proportion of the total revenue is collected in the first four months of the calendar year. The heavy collections of revenue which then take place undoubtedly have a considerable effect on the money market, but the trouble is minimised in two ways, first because the money collected is immediately deposited at the Bank of England, where it is available for financing the commerce of the country; and, second, by the device of Treasury bills for supply and ways and means, ways and means advances and deficiency advances, which enable the Government to tide over the lean period of the year by borrowing from the market sums which they repay as revenue accrues later on, thus maintaining some sort of equilibrium in the demands of the Exchequer upon the cash supplies of the nation. This is a device not practicable in India, where the resources of the money market are as yet too limited to enable the Government to rely on financing themselves through the lean months by borrowing. In India, therefore, the minimum balance of the Government must be sufficient for their wants and the money collected as revenue is necessarily under present conditions taken off the market and immobilised in the Reserve Treasuries.

138. The disadvantages of the system are accentuated by the special conditions of India, where business is subject to a seasonal tide of strongly marked character. That business it will be remembered is predominantly agricultural, and all the principal crops, whether jute or rice, cotton or wheat, or oil seeds are marketed in the autumn and winter. Thus every year there is a busy season with active trade and great demand for money, and a slack season when money frequently cannot be lent. Something of the same sort occurs also in the affairs of Government; and far more than the proportionate amount of the revenue is collected in the first few months of each calendar year. We have noted that the minimum balance is reached in November or December. From that point the balance begins again to rise, and by the end of March is normally 4,000,000*l.* higher than in December. This season of maximum collection of revenue coincides with the season of busiest trade, and thus it happens that, at the time when the market stands most in need of funds, the Government are taking off the market a sum of 6 or 7 crores not for the sake of immediate requirements but in order to meet disbursements during the slack season of the summer and autumn.

139. The figures of the closing balances in India on the 31st March 1913 are instructive in this connection. Instead of the normal balance of about 12,000,000*l.* the total balance was 19,268,200*l.*, which was distributed as follows:—

	£
In 270 district treasuries - - - - - - -	6,590,500
In 35 branches of Presidency banks - - - -	2,198,300
In 3 head offices of Presidency banks - - - -	1,595,600
In 3 Reserve Treasuries - - - - - - -	8,908,700
	£19,293,100

Close on 9,000,000*l.* was thus locked up from the market in the Reserve Treasuries as compared with about 3,500,000*l.* a year before, while only 3,752,100*l.* out of the total of 19,268,200*l.* was placed with the banks. Only a comparatively small portion of the 2,198,300*l.* deposited at branches of the banks can be regarded as readily

available in the money market, but as this money would for the most part necessarily be located in much the same places under any system, it may be counted as being at any rate more available for trade than if it had been in district treasuries. The causes which led to this state of things on the 31st March 1913 were mainly a sudden slackening off in the demand for Council drafts, unaccompanied by any noticeable slackening of internal trade in India, and a record surplus of revenue over expenditure. It appears to us that a system which leads in certain circumstances to the locking up of nearly 9,000,000*l.* during the busiest period of the commercial year, and 5,400,000*l.* more than under the same system was similarly locked up in the previous year, requires very strong justification.

140. We have said that Government cannot sacrifice the interests of the general taxpayer to the interests of trade. Nevertheless, we should be the first to recognise the immense importance of trade to the prosperity of the country and the revenues of Government. The principles now observed result in loans being granted from Government balances only in exceptional circumstances, and while there is a provision that Presidency banks may retain on payment of interest sums in excess of those which it is the practice to leave with them, this provision appears to have had little publicity and has not been acted upon. In effect we may say that the assistance rendered by Government to trade has so far been confined to the amount left at the headquarters of the Presidency banks.

141. At the same time there are those who hold that the disadvantages of the Indian system have been exaggerated. Two points must here be noted.

142. In the first place the view has been expressed that the bank rates ruling in India are not after all excessive. During the busy season these rates generally rise as high as 8 per cent., and in some years they have remained at that figure for a considerable time. Occasionally they have risen even higher. But this does not mean that the average bank rate in India is high. On the contrary, it is possible for firms and individuals who can offer good security to borrow money all the year round at an average rate of interest very little, if at all, higher than would be charged for similar accommodation in the United Kingdom. In these circumstances it is argued that there is no real ground for complaint and that trade can easily afford the higher rates of the busy season.

143. This view was expressed to us by several witnesses, including the representatives of the Exchange banks, but it was not generally shared by other witnesses. There is much to be said for the complete neutrality of Government in such matters, but complete neutrality, by which we mean the absence of influence one way or the other on the rates for money, is not practicable in India in present circumstances. The action of Government undoubtedly helps to create the annual stringency, and there is therefore at least a *prima facie* case for such counteraction as is possible to relieve it.

144. Second, it is said that the stringency in the Indian money market, so far as it is caused by the withdrawal of money by Government, is relieved by the sale of Council drafts, which again place the surplus held by Government at the disposal of trade. This is largely true, but it omits some factors of considerable importance. The demand for money arises in the first place from the necessity of financing the movement of crops up country, but Council drafts are taken only when the produce is ready for export; there is thus an important period during which the needs of the market are not met by this means. It is obvious also that the sales of Council drafts are affected by circumstances quite independent of the Indian money market; a high bank rate in London, for instance, or the holding back of produce in India for higher prices, may result in the demand for Council drafts being slack in the busy season, while revenue collections are as heavy as ever. In this case the money so collected accumulates in the Reserve Treasuries and remains locked up there. As an illustration of this effect we may point to the experience of last cold weather, to which we have already alluded, when there was a marked falling off in the sales of Council drafts, with the result that enormous sums accumulated in the Indian balances and at the same time the bank rate was high in all three Presidencies. Finally, even when Council drafts are being freely sold, a temporary surplus, as we have observed, is left in India during the closing months of the financial year which is not immediately required for Government purposes; and as far as this temporary surplus, at any rate, is concerned, the argument that the sale of Council drafts relieves the stringency caused by the action of Government has no relevancy.

145. We arrive, therefore, at the conclusion that the present methods of dealing with balances are open to criticism, and we proceed to consider what remedies can be suggested for the evil of which complaint is made. For the purposes of this inquiry it seems desirable to review the discussions which in the past have centered round the utilisation of the balances in India. From 1863 to 1876, the whole of the Government balances at headquarters were handed over to the Presidency banks. On one or two occasions, however, the Government were not able to obtain on demand the free use of the balances deposited with the banks, and the difficulties which they experienced led in 1876 to the establishment of the Reserve Treasuries. It was felt that a Government exposed in a peculiar degree, as the Government of India undoubtedly are, to sudden demands and unforeseen contingencies could not afford to lose control of their balances, and in addition it was urged that the system which was about to be superseded was wrong in principle. "Capital supplied by Government," observed the Secretary of State, "and not representing the savings of the community is a reserve "on whose permanence no reliance can be placed . . . . a political exigency "withdraws the adventitious resource, and the commerce which trusted to it finds "itself pledged beyond what its own resources can make good."

146. On the other hand, it must be mentioned that, in the correspondence which led to the establishment of Reserve Treasuries, the same authority said that it would be open to the Finance Department in India either to retain the reserve in the Treasury or lend it out for short terms on suitable conditions as to interest and security. The question of Reserve Treasuries and of loans from Government balances has been a subject of discussion from time to time ever since. In 1888, the Bombay Chamber of Commerce raised definitely the question of loans by Government in the busy season, pointing out that the Treasury balances are at a maximum at precisely the period of greatest demand for funds. The Government, however, held to the position which they had taken up in 1876; they referred to a paper by Sir James Westland, to show that their balances were not excessive and that the method of dealing with them was sound; trade, they thought, should depend on its own resources and systematic advances by Government in the busy season would tend to reduce the working balances of the country to an unsafe minimum with consequent risk of panic, to guard against which was an important object of the Reserve Treasuries. If advances were made below the published rate, they added, it would be difficult to confine the privilege of obtaining Government money to the Presidency banks; these banks would be tempted to speculative operations with State resources, allowing their own resources to fall below the limit of safety. The conclusion of Government, therefore, was that they should confine any assistance from the Treasury to loans through Presidency banks at the published rate of interest in relief of temporary stringency.

147. In 1898 the Bengal Chamber of Commerce renewed the proposal, pointing out that the question was not one of wholesale surrender of Treasury funds to the Presidency banks, but the discretionary disposal of them in periods of stringency. On this occasion the proposal had better success with the Government of India, for after some hesitation they proposed to the Secretary of State that it should be recognised as part of the ordinary business of management of the Treasury balances to lend money to the Presidency banks at 1 per cent. less than the declared minimum rate of interest during the months of January to May of each year. The Secretary of State, however, was unable to accept the recommendation of the Government of India. The effect, he thought, would be to interfere with the remittance to England at a favourable rate of exchange of the amount necessary for the discharge of the sterling obligations of Government—a point on which we have already touched and to which we shall return. Any general understanding of the kind proposed, he added, would induce trade to lean even more than it had done in the past on the assistance of Government instead of taking steps to enlarge the amount of loanable capital in the country. The grant of loans in India accordingly was made subject to the retention by Government of an amount sufficient to meet not only their disbursements in India but the probable amount of remittances to England. On this condition loans were permitted, but the Secretary of State thought that they should not as a rule be made below bank rate, and this rule in fact has been followed ever since by the Government of India. Our opinion on the various points raised in this correspondence will appear from what follows.

148. The most obvious solution of the problem would be to close the Reserve Treasuries and to place the whole of the Government balances in Calcutta, Bombay and Madras, with the head offices of the Presidency banks there, or, if the Government

attach great importance to having a reserve immediately under their control, it might seem enough to fix a maximum total, (say) 1,000,000*l*. or 2,000,000*l*., to the amount to be held in the Reserve Treasuries, and to place the remainder with the banks. The banks would naturally be called upon to make a suitable payment to Government for such additional privileges.

Such a change would involve a reversal of the action taken in opening the Reserve Treasuries in 1876 and the following years. It does not, however, necessarily follow that the action then taken was injudicious. The Presidency banks have enormously expanded their business in the interval, and the proportion of Government deposits to private deposits would be very much smaller now than in 1876.

149. It remains true, however, that if this solution were adopted the proportion of the Government deposits to those of other customers would still be much larger than is usual in the case of any European Government, and there is certainly danger in allowing the somewhat restricted money market in India to rely too much on the use of Government funds. Moreover other difficulties would arise: for the Treasury balances and the Paper Currency Chests are closely inter-connected in the resource operations of Government throughout India; and there are some important questions as to the provision of funds in India for meeting Council drafts also to be considered in this connection.

150. The alternative to the closing of the Reserve Treasuries is that Government should make loans from their balances. This is the course which we recommend on the understanding that the amount of the loans is within the absolute discretion of Government, and that they are made only on good security and for short periods. At the end, however, of a discussion which has lasted for more than 30 years, the Government are not in the possession of any effective system of making such loans and the question is clearly one which deserves the most careful consideration.

151. It appears to us that this proposal has been prejudiced in the past by a failure to distinguish it from other proposals which we do not favour. This is clear from the correspondence of which we have given a resumé. The general argument which Lord Salisbury, as Secretary of State, used in his despatch of 6th May 1875 (Appendix II., page 32), against the use of Government funds as permanent capital, was relevant and effective against the system which till then was in force, of making over the central balances permanently to the Presidency banks, but it was employed at a later date by the Government of India as a reply to a suggestion for temporary loans during the busy season. Similarly in dealing with the same proposal when made by the Bengal Chamber of Commerce in 1898, Sir James Westland went back to the radical differences between English and Indian conditions which justify the Government of the United Kingdom in keeping their balances with the Bank of England, but make it unsafe for the Government of India to keep all their money with the Presidency banks, and he again suggested that the proper cure for stringency during the busy season in the Indian money market was the increase of banking capital. These considerations do not apply to the scheme which we are now contemplating.

152. The arguments which are still urged against the grant of loans in India are put forward partly in the interests of Government and partly in the interests of trade. The main arguments which are based on the interests of Government are two in number. In the first place it is said that the contingencies and sudden demands to which the Government of India are subject are so numerous that they cannot safely make loans out of their balances. It is true that the circumstances of the Government of India are such as to require a policy of great caution in financial administration. But the loans which we contemplate will not deprive the Government of the use of any portion of their balances for more than a short period, and they will be made only in the discretion of Government, and we cannot agree that the argument applies to loans of this kind.

153. Again, it has been urged that the policy of granting loans in India may interfere with the remittance of Government funds to England at the most favourable rate. To this argument it might be sufficient to reply that it is clearly not applicable in all circumstances; we need only refer once more to the conditions of the cold weather of 1912–3, when the demand for Council drafts was smaller than usual and it is clear that the question of exchange did not enter into the problem of disposing of the Indian balances. For such cases it seems essential that the Government should retain discretion to grant loans.

154. But we would go further, and suggest that even under normal conditions the problem of exchange may not present such difficulties as are sometimes anticipated. What is in the minds of those who urge this objection is that the grant of loans from the Indian balances will reduce the demand for Council drafts in the busy season when exchange is at its highest, and that, consequently, there will be a loss when the Secretary of State finds that he has to draw money to London at a less favourable season. It appears to us, however, that the effect of such loans cannot be to reduce the aggregate amount of Council drafts sold; at the most, it can result only in a shifting of the sales from one part of the year to another, and it is not clear that, if the exchange in consequence falls at one time, it will not be correspondingly improved at the other. To a certain extent, the number of bills might increase at the expense of telegraphic transfers, since the first are used more largely in the slack, and the second in the busy season; but against any slight loss caused in this way would have to be set the interest earned in the meantime on the Indian loans. The last Financial Statement of the Government of India noticed the tendency shown in recent years for the busy season to encroach on the slack, and this tendency would probably be strengthened by any reduction in the price of money in India during the months of heaviest demands. On this point, however, we have no wish to dogmatise, and we content ourselves with saying that, in our judgment, there is nothing in the exchange question which would justify the Government in a general policy of refusing loans in all circumstances.

155. On the other hand, there are two distinct advantages which the Government forego when they refrain from making loans. The first is the interest which would be earned on any surplus balance which may be held in India in excess of immediate requirements. The second is concerned with the permanent loans which Government raise yearly in the Indian market, with which we deal later.

156. The argument against the grant of loans in India which is based on the interests of trade is that the Treasury balances of the Government are a very uncertain quantity, that consequently the assistance rendered to trade by loans from these balances would be spasmodic, and that inconvenience or worse might result if on occasion it were necessary for Government to refuse the assistance to which trade had become accustomed. If it is sought, however, to apply this argument to temporary loans during the busy season, we are not impressed with its cogency. When that season of the year is reached, the results of the monsoon have been established and the Government can calculate the financial prospects for the next few months with considerable accuracy. Nor is it to be supposed that the continuance of the same amount of assistance year after year would be taken for granted. The progress of the revenue and expenditure of the Government is well known to the public; the banks themselves could generally forecast whether the Government were likely to be in funds. The outlook would be discussed from time to time by them with the Government, and they would not base their arrangements on the assumption that they would receive a loan without some assurance that the money would be available. The unexpected indeed may always intervene and the derangement of plans in that case would certainly prove inconvenient both to the Government and to the commercial world, but it does not appear to us reasonable that the fear of such a contingency should deprive the market year after year of the surplus funds of Government.

157. It was, however, in view of this objection that several witnesses made proposals for loans from the Paper Currency Reserve as a preferable alternative to loans from balances, on the ground that loans could be made with safety from that Reserve at times when the Government happened not to have surplus balances in India. There is a very close connection between the two alternatives, because the greater part of the amounts locked up in the Reserve Treasuries usually consists of Government notes. The figures for the 31st March 1912 and 1913 respectively were:—

	Amount in Reserve Treasuries.		Amount of Notes.
	£		£
1912	3,506,000	(5.18 crores)	3,453,000
1913	8,908,000	(12.68 crores)	8,453,000

Thus, 5,000,000*l*. out of the extra 5,402,000*l*. located in the Reserve Treasuries on 31st March 1913, as compared with 31st March 1912, consisted of notes. As the

fiduciary portion of the Paper Currency Reserve has hitherto been a fixed amount, the result of accumulation of a surplus balance in India has been to lock up an approximately equal amount of metallic currency in the Paper Currency Reserve.

158. It would accordingly make no practical difference to the Indian money market whether loans were made from the balances or from the Paper Currency Reserve, if the amounts lent were the same; and provided that due precautions are taken we think that both sources may be used for the purpose of loans. We therefore recommend that the Government should declare their willingness to grant loans from balances in India when it is in their power and interest to do so. We proceed to define the conditions and terms under which we think loans might be given.

159. There are three different ways in which the grant of a loan may become possible. In the first place, as already pointed out, the Government in the ordinary course hold an unemployed balance in India, namely, the difference between the true minimum working balance of November or December and the figure to which the balance is raised by the additions made to it from then onwards during the busiest months of the year, and there is no reason why normally some or all of this surplus, according to the circumstances of the time, should not be placed at the disposal of trade. Second, it may happen, as in the early months of 1913, that the Government of India's balances expand far beyond their usual dimensions; and here again it seems of distinct advantage to the parties concerned that Government should lend as much as they prudently may and as much as the commercial community can utilise. Finally, while recognising that the first duty of the Government is to secure the transmission of the necessary funds to London on favourable terms, we think that in some circumstances the Government might fairly consider whether some portion of the funds, which must ultimately be so transmitted, might not, without loss or inconvenience, be retained for a time in India.

160. We fully admit that at this point various considerations come into play. There is the question for instance to which we have already referred of the rate of exchange, and of the possibility that, if full use is not made of the earliest opportunities for remittance, difficulty may be subsequently experienced in transferring to London the money ultimately required there. It must further be remembered that the undertaking of the Secretary of State to sell Council bills without limit at 1*s.* 4⅛*d.* per rupee is of material importance in this connection. Then again there is the question of the comparison between the rates of interest obtainable in England and in India respectively, and of the amount which can be safely placed in the one country or the other.

161. But it does not seem to us that the various factors which have to be considered have in the past been fairly set against one another. Indeed a division of business between the Home and Indian authorities has been adopted which seems to us anomalous. The management of the balances in India, it is said, rests with the Government of India. On the other hand, the administration of Council drafts is recognised to rest with the Secretary of State. But it does not seem to have been clearly grasped that the two are inter-dependent. We have been told that the policy adopted with respect to Council drafts has in fact been to sell freely so long as there was a demand and so long as there were balances sufficient to meet them. In other words, it has been assumed that the proper place for any surplus balances is London. In the great majority of cases this may have been true, but no such general assumption can properly be made when the circumstances are constantly varying. The location of any surplus balances should be determined on a consideration of all the factors. It should be determined further in consultation between the Home and the Indian authorities, and the possibility of the grant of loans to the Indian market should always be considered.

162. The bulk of the evidence offered to us on the subject of these loans has been directed to such questions as, to what authorities should advances be made, what amounts ought to be granted or will be sufficient to prevent stringency and on what terms should they be allowed. With these questions we can deal quite briefly.

163. We think that in the first instance at any rate loans should be confined to the Presidency banks. As occupying a special place in relation to the Government, they are the natural recipients of such loans, and we have no doubt that through them any benefit in easier rates that may accrue will find its way to the other users of money. We observe that the representatives of the Exchange banks agree with this view.

All such loans should be secured by the deposit of securities of the Government of India or Port Trust Stocks or similar securities.

164. As regards terms it is clear that, if the objects which we have in view are to be achieved, the present conditions cannot be maintained. In the great majority of cases loans will be possible only when there is a strong demand for money, but we see no reason why the discretion of Government should be limited and loans allowed only in periods of stringency. In any case it seems undesirable to fetter the discretion of Government by making it a condition that no loans are to be granted until the bank rate has reached a particular point. Our attitude is much the same to the proposals frequently made, that loans when granted should be at a prescribed level, whether 1 per cent. or 2 per cent. below bank rate. We think the Government should enter into negotiations with the Presidency banks and lend to them if the terms offered are satisfactory.

165. The question how much may be needed to relieve stringency can only be solved by experience. The amount of the loans will be in any case what the Government, with due regard to all the circumstances of the time, can afford to make and the market can utilise. We do not conceal from ourselves that our general recommendations on this subject involve a considerable departure from previous practice, and may have far-reaching consequences. We advise therefore that in carrying out our proposals the Government should proceed with caution. It is desirable that the change from the old to the new should be gradual and that its effects should be carefully watched. The first steps must be tentative, and in the early stages the Government of India should keep their advances within easily manageable limits.

166. The ultimate effect of these loans upon the Indian money market will be somewhat similar to that which is produced in the United Kingdom by the system of temporary borrowings by Government during the summer and autumn, which are repaid to the market when revenue comes in during the winter. But there is an important difference between Indian and British conditions in this respect owing to the fact that the Government of India are constant borrowers, both in London and in India, for permanent capital expenditure on the development of India's natural resources. The Indian Government regularly go into the money market in India during the summer for a loan in the form of rupee paper. In accordance with the recommendation of the Committee of 1898 (para. 70), that the Indian Government should restrict the growth of their gold obligations, and in view of the well-known advantages of internal over external debt, it has been the recognised policy of the Government to raise in India as large a part as possible of the sums which they require to borrow each year.

167. We have had some evidence, however, to the effect that of recent years the Government's estimates of the amount that could be raised by loans in India have been unduly cautious. The late Finance Member of the Viceroy's Council himself stated in evidence that he had deliberately pursued a cautious policy in this matter. We think that the criticism that undue caution has been used is justified, though the amount involved may not have been very large. It is supported by the facts that at the moment the Government pay less for their borrowings in India than for what they raise in London, and that besides taking up the new issues of rupee paper India has in the last ten years been buying some of the holdings of this security in the United Kingdom.

168. In any case those who are qualified to speak on behalf of the Indian banking community are all agreed in stating that larger loans could be issued each summer in India, if some means were available for counteracting the stringency that recurs annually in the winter and early spring. The practice of making loans from the Paper Currency Reserve and from balances will certainly assist the Government in increasing their annual rupee loans in the summer. The banks would probably be glad to keep larger holdings of Government stocks, if by so doing they did not run the risk of having insufficient liquid resources in the busy season. For the last two years the rupee loan issued in India has amounted to three crores or 2,000,000*l*. If the Government could count on raising larger sums each summer in permanent loans it should be possible for them to reduce to an equivalent extent their estimate of 12,000,000*l*. as the amount of the closing balance required on the 31st March to tide over their summer and autumn requirements. As their capital outlay occurs mainly in the United Kingdom, they will thus be able to

release, in payment for Council drafts, some part of the amounts now locked up in the Reserve Treasuries during the busy season.

169. We call attention at this point to the evidence given by some witnesses to the effect that the requirements of the Government of India as regards the endorsements upon the rupee paper and the general form of this security militate against its popularity, particularly among small investors in India. Any reforms which will induce Indians to invest their savings rather than hoard them in metallic form are greatly to be encouraged. We therefore recommend to the attention of the Government of India the questions of the desirability of some relaxation of the present regulations in regard to rupee paper and of creating new forms of securities, such as Treasury bills, short term bonds, or stock redeemable within a moderate period, likely to be taken up by persons to whom rupee paper does not appeal.

(4) Sales of Council Drafts.

(a) *History.*

170. It will be convenient, before turning to the examination of the India Office balance in London, to consider the method of effecting remittances on Government account between India and London, viz., the system of sales of Council drafts. For convenience we use the word drafts to cover both bills and telegraphic transfers.

Sales of Council bills and telegraphic transfers on India by the Secretary of State in London are the central feature of the machinery by which the Indian finance and currency system is at present managed, and a correct understanding of the nature and objects of these sales is the key to the whole system. We have already had occasion to refer to these sales and their uses in several connections; we propose now to consider the system in detail.

171. The practice of drawing funds from India to meet the home charges by means of bills of exchange on India was inherited by the India Office from the East India Company. The present procedure is as follows:—On each Wednesday a notice is exhibited at the Bank of England inviting tenders, to be submitted on the following Wednesday, for bills of exchange and telegraphic transfers on the Indian Government authorities at Calcutta, Madras, and Bombay. The notice states a limit which the aggregate amounts will not exceed. The Secretary of State does not bind himself to allot the whole amount mentioned in the notice, and as a matter of practice does not accept any applications at prices lower than 1*s.* $3\frac{29}{32}$*d.* per rupee for bills and 1*s.* $3\frac{15}{16}$*d.* for transfers. The price charged for telegraphic transfers is ordinarily higher by $\frac{1}{32}$*d.* per rupee than that charged for bills, but when the Calcutta or Bombay Bank rate exceeds eight per cent. tenders for transfers rank for allotment with tenders for bills only if they are $\frac{1}{16}$*d.* higher. Allotment is made to the highest bidders and when the total amount tendered exceeds the amount offered allotment is made pro rata. When the tenders received on a Wednesday have been dealt with, the amount to be offered for tender on the following Wednesday is decided upon, the main considerations being the requirements of the India Office and the strength of the demand. "Intermediate" or "special" bills and transfers can be obtained on other days of the week at a price fixed by the India Office at not less than $\frac{1}{32}$*d.* higher than the lowest prices at which allotments have been made on the preceding Wednesday, the exact rate and the maximum amount of such "intermediates" being fixed for the week each Wednesday.

The arrangements made each Wednesday are laid before the next meeting of the Finance Committee of Council, usually on the same day, and subsequently before Council itself, for approval.

172. Up to the time of the closing of the mints to silver in 1893 this weekly auction of Council drafts was nothing more than a simple and effective means of laying down in London the funds required by the Secretary of State for home charges at as favourable a rate as possible. In times of active trade the Secretary of State sometimes took advantage of a favourable rate of exchange to bring over from India rather more than was needed to meet his immediate requirements, to the mutual advantage of the Indian revenues and of trade. But the system existed simply as a means of remitting to London so much of the Government balances as it was

desirable to make available in London. Its main justification lay in the fact that it was both effective and profitable to the Indian Government, and convenient to trade in providing a ready means of settling a large part of the debts due by people in this country (and elsewhere) to people in India for the surplus of exports over imports. Indeed it may be said that it is the large surplus of net exports over net imports which characterises Indian trade in all but abnormal times that makes the system of sales of Council drafts both possible and profitable.

173. With the closing of the mints to silver in 1893, the system of sales of Council drafts assumed new importance, and has been gradually extended in more than one direction. It was by a temporary cessation of the sale of Council drafts that the authorities first tried to force the exchange value of the rupee up to 1*s.* 4*d.* Then, when the rupee finally reached 1*s.* 4*d.* in 1898, under the Act No. II. of 1898 already referred to Council drafts were sold against gold set aside at the Bank of England as a part of the Indian Paper Currency Reserve, and paid for in India out of notes issued against such gold. The object of this action was no longer simply to lay down funds in London for the Secretary of State's home charges, but so to alter the location and disposition of the general resources of the Government of India as to provide a means in a time of great stringency, with the Calcutta and Bombay bank rates standing at 11 and 12 per cent., for quickly expanding the currency as an alternative to the shipment of sovereigns to India on private account when the Government of India had no surplus Treasury balances with which to meet Council drafts.

174. With the development of the Indian currency system on existing lines, and the continued demand for rupees rather than sovereigns for circulation, this new departure of 1898 was developed, and Council drafts came to be used as a means of avoiding the useless accumulation of sovereigns in the Paper Currency Reserve in India. Government had undertaken the obligation of providing rupees in India in exchange for sovereigns at the rate of 1*s.* 4*d.* per rupee. Instead of waiting for the sovereigns to be tendered in India, and accumulate there till they had to be shipped home at Government's expense to purchase silver for coinage into rupees, the Government, as already explained, found it profitable to offer to sell Council bills without limit of amount at 1*s.* 4⅛*d.* per rupee, thus receiving payment for the rupees in London instead of in India at a rate of exchange which corresponds roughly with the fixed value of 1*s.* 4*d.* for rupees in India. The money so received in London is either earmarked as a portion of the Paper Currency Reserve at the Bank of England or used to purchase silver with which to coin rupees to take the place in India of those issued to pay for the Council drafts. A similar train of events has resulted in the issue by the Secretary of State, as occasion requires, of notifications offering to purchase sovereigns in transit from Australia or Egypt to India.

175. Finally in 1909 and 1910, when the exchange crisis of 1907–8 was over, Council drafts were sold freely in order to obtain sterling in London in place of the large quantities of rupees which had accumulated in the Gold Standard Reserve in India through the sale by the Indian Government of bills on London during the crisis, these Council drafts being sold not to provide funds for home charges, but to bring back to London the Gold Standard Reserve fund; and it is by means of sales of Council drafts that the profits on the mintage of rupees, which necessarily first take the form of rupees, are converted into sterling in London, the rupees which represent the profits being issued in India to meet the Council drafts sold in London.

176. It will be seen that the considerations affecting Council drafts are now very much wider than the mere question of laying down in London the funds required for ordinary home charges. The transfer to London from the Government of India's balances of some 20,000,000*l.* annually for the home charges on revenue account and of some 6,000,000*l.* or more to meet capital expenditure remains the chief function of the sales of Council drafts; but if the expense and waste involved in the shipment of sovereigns from India to London on Government account is to be avoided, it is necessary for the Secretary of State to sell sufficient drafts, not merely to meet his own requirements on revenue and capital account, but also to satisfy the demands of trade up to such an amount as will enable the balance of trade in India's favour over and above the amount of the home charges on revenue and capital account to be settled without the export to India on private account of more gold than is actually required in India for absorption by the public.

(*b*) *Management.*

177. The system of Council Drafts has frequently been described as artificial, but within limits, which we shall indicate, it is perfectly natural and would apply whatever might be the currency system in force. The criticism, in fact, that the system is artificial arises chiefly, we imagine, from the fact that the exchange is transacted by the Government themselves, *coram publico*, and little would be heard of it if the Secretary of State's remittances were made through a bank.

178. On the general description of the system which we have given, there cannot, we think, be much disagreement. But differences of opinion at once appear when an attempt is made to define the limits within which its operation is justifiable. The procedure actually adopted, we have been told, in recent years has been to sell Council Drafts freely, that is to say, to sell as long as there was a demand and as long as it could be met from the resources of Government in India. This statement of the case, however, does not appear to enunciate clearly any principle, and if it is desired to lay down a rule for future guidance we must inquire what is really involved in it. The procedure indicated would seem to be based on one of two alternatives. It may be held, in the first place, that the proper location of the surplus balances of Government is in London, and that as soon as they accrue they should be remitted from India. With this aspect of the case we have dealt already. Or it may be said that it was necessary for Government to supply up to the limit of their power the demand of trade for funds in India, and this position has been taken by some of the witnesses in explanation of the large sales of Council Drafts in recent years. We have already said that we do not favour the view thus implied. The interests of trade are, indeed, of high importance, but it is not the business of Government to favour trade at the expense of general revenues.

179. On the other hand, we have been asked to consider various limitations on the amount of Council Drafts to be sold. Thus it has been suggested that the Secretary of State should never sell more than the amount of his home charges, or that he should restrict his sales to the amount entered in the budget estimates, or, again, that he should adjust the sales in such a manner as always to keep his home balance from rising much above the working figure of 4,000,000*l*. To limitations of this kind also we are opposed. The right view is that the extent of the sale of Council Drafts depends on the requirements of Government, whether immediate or prospective, for funds in England. It is true that this principle leaves the Government a wide discretion, and that they may not always exercise it wisely. Their action might then be criticised on the ground that they had brought funds to London prematurely: but this is beside the present point. The fact remains that, while in consequence of recurring surpluses over budget estimates, the London balance has been abnormally high for the last few years, no money has been brought home which has not been used or will not be used for Indian Government requirements in the United Kingdom.

180. On one hand, therefore, the interests of trade are in themselves no justification for sales of Council Drafts in excess of requirements as we have defined them; for if, to accommodate trade, the Secretary of State were actually to go beyond his own needs, it would mean that he would bring to London money for which he had no need and that sooner or later he would have to send it back to India. On the other hand, the attempt to limit sales in advance to any particular sum is arbitrary and unnecessary. The suggestions which we have received in this connection are based on the assumption that Government ought never to bring home more than their immediate requirements, but any such limitation of the discretion of Government would merely interfere with the economical management of their remittance business without securing any other advantage. Suggestions of this kind seem to be inspired by the feeling that the present system is artificial or that undue assistance is given to trade when sales are less restricted. So long, however, as the Government do not exceed their requirements these fears are groundless. If the Government were to exceed their requirements, they would lay themselves open to the charge of manipulating Government funds for the benefit of trade. Within the limits of those requirements the advantage given to trade is in no sense artificial: there is a corresponding advantage on the Government side, and both arise from that interchange of obligations and resources which forms the general basis of the Council Draft system.

181. From the general limits within which the system is sound we pass to a consideration of the rates at which Council Drafts should be sold. As things are

at present, the India Office make a practice of selling Drafts on every Wednesday throughout the year so long as the rate for bills is not below 1*s.* $3\frac{29}{32}$*d.* This is done even if the India Office balance is high enough to dispense with this source of supply for the time being. Several witnesses have criticised this practice, and its justification is not very clear when there is no particular need at the moment for the proceeds of such sales. It is argued in favour of the practice that in this way the India Office are able to feel the pulse of the market and take advantage at once of any increase in demand. But this object could be attained by continuing the invitation for tenders weekly while refusing to sell at very low rates except when money is actually required.

182. Some witnesses, however, went further and urged that the Secretary of State should always sell at a fixed rate, say 1*s.* $4\frac{1}{16}$*d.*, or that he should never sell below par. We are opposed to these suggestions. With regard to the first proposal, we would observe that while the Government are very large dealers in the exchange market, they are not monopolists; and it seems doubtful if they could successfully stand out for any such rate at all times of the year. The increased uncertainty as to the regularity of sales which this policy involves would make it necessary to hold larger normal balances in London than would be otherwise required. The effect of the second proposal, whatever might be the lower rate adopted, would be to limit the range of variation of exchange. With the general object of this proposal we have some sympathy, since the range at present is extensive, and must discourage the free movement of capital between India and other countries. Nevertheless that range, depending as it does on the cost of freight and insurance to India, is the natural range, and any restriction of it would impose additional responsibilities on the Government, for which we find no adequate justification. We consider, therefore, that the Government should continue to follow the market rate, effecting their remittances whenever they find it profitable to do so. In other words, the propriety of the transactions of Government in the exchange market must be judged with reference to the urgency of their requirements and the rate obtainable.

183. In what we have said so far we have had in mind primarily the remittance of Treasury balances, but the same considerations apply also to Council Drafts sold for the purposes of the Paper Currency or Gold Standard Reserves. It has been stated that the system of selling Council Drafts to be met from the Paper Currency Reserve in India originated in the desire to assist trade when Government were unable to meet demands for remittance from their treasury, but it will be clear from what we have said that we do not regard this as a sufficient reason. The justification for such sales must be that, whether for the purchase of silver or for some other purpose, it is considered desirable to hold part of the Paper Currency Reserve in London. Similarly, in the case of the Gold Standard Reserve the sale of Council Drafts is proper in circumstances in which funds belonging to that Reserve have to be transferred to London. In either case the real grounds for remittance must be the home requirements of the Government.

184. We hold, therefore, that, even in the case of the Paper Currency and Gold Standard Reserves, the Secretary of State must have discretion to draw within the limits of what are termed the gold points at the rates obtainable when the remittance becomes necessary. An instructive example of the need of such discretion is supplied by the experience of 1909, when, after the crisis of the preceding two years, a large amount belonging to the Gold Standard Reserve had accumulated in India and was remitted home at a rate considerably below the par of exchange. It has been urged that it would be better when funds belonging to the Gold Standard Reserve are concerned to defer remittance till a rate above par can be obtained. But the first necessity at such a time may be to get the funds to London as soon as possible, in order that they may be available for use in case of any further disturbance of exchange, and we should be unwilling to limit the discretion of the Secretary of State in such circumstances.

185. The opinion is often expressed that, while ordinarily the question of rates may be treated on the lines which we favour, further considerations arise when the sales involve new coinage; and it is suggested that Council Bills should not then be sold below 1*s.* $4\frac{1}{8}$*d.* The suggestion, however, seems to draw too sharp a distinction between the various funds of Government and the purposes to which they are applied. It is always possible, for instance, that the silver required for coinage may be purchased from Treasury funds at home, a transfer being made from the Paper Currency Reserve to the Treasury in India when this silver is shipped and becomes part of

the Paper Currency Reserve, and Council Drafts in that case would have to be paid for sooner or later out of the Treasury to make good the home expenditure. Moreover, the suggestion has in view only the gold point as between India and England, whereas rupees may have to be given in exchange for gold imported at various rates from Egypt and Australia and elsewhere. Since further coinage becomes necessary only in times of active trade, exchange naturally tends to be high when fresh coinage is required. It is desirable that sales for the purpose of new coinage should be kept as closely as possible to specie point (whatever that point may be at the moment): but we think it undesirable to limit the Secretary of State's discretion by rigid rules.

186. We sum up our views as follows:—We cannot agree that the India Office should make a point of not selling drafts in any circumstances below gold export point or below any arbitrarily fixed rate. The general policy pursued at present is, in our view, the right one, viz., to regulate the time and amount of the sales of Council drafts throughout the year according to requirements, so as to take full advantage of the demand for such drafts in order to lay down funds in London. Though the convenience of trade and the regulation of exchange are important considerations for the India Office in the management of the system, we think that in some of the explanations of it given to the public, too much stress has been laid upon this aspect and too little attention has been directed to the primary and by far the most important function of Council drafts, viz., the transfer to London from India of public funds to meet the requirements of the Secretary of State in London. This is true not only of those Council drafts which are met from Treasury balances in India, and serve simply to transfer part of the cash balance from India to London, but also of those which are met from the Reserves in India, since the object of the sales of these drafts is to lay down in London such portions of the two Reserves as the Secretary of State and the Government of India desire to locate in London, either permanently as in the case of the Gold Standard Reserve or the gold portion of the Paper Currency Reserve earmarked at the Bank of England, or temporarily as in the case of moneys belonging to the Paper Currency Reserve which are transferred to London for the purchase of silver for coinage. This is one of the points in which it is particularly important not to overlook the fact that the various funds concerned are, as we have said, really one single whole. If a broad view of the situation is taken, it can be said without departing from accuracy that Council drafts are sold for no other reason and to no larger amount than is necessary to meet the requirements, present or prospective, of the Secretary of State in London.

(5) India Office Balance.

187. We now turn to the examination of the London balance. The primary purpose of the India Office's balance in London is to provide ways and means for meeting the expenditure incurred in the United Kingdom by the Secretary of State on behalf of the Government of India. This expenditure now amounts to something over 20,000,000*l.* a year on revenue account alone, *i.e.*, on salaries, pensions, stores of all kinds, and interest and management of debt, and as the amount of Indian debt outstanding in this country tends to grow, this figure is at present increasing slowly year by year. In addition very large sums, estimated in 1913–4 at close on 9,000,000*l.*, are required for capital expenditure in London in connection with railways, irrigation works, &c., in India; and the repayment of temporary debt and the guaranteed debentures and bonds of Indian railway companies, whether the money for such repayment is found by fresh borrowing or not, makes considerable calls on the London balance.

188. This balance is fed mainly from two sources, the proceeds of the weekly sales of Council drafts and loans raised in London. There are certain direct sources of revenue which are of little importance, and a variant of the second source is found in the payments made into the balance by Indian railway companies out of the proceeds of the issue of guaranteed stock or bonds issued by or on behalf of those railways, the Indian system being that the Government are shareholders in most of the railways, and act as their bankers both in London and in India. The Secretary of State has a very considerable amount of control over the time and amount of such issues, which may accordingly be regarded for our present purpose as being in the same category with Indian Government loans raised in London.

189. As already stated, the normal balance required on the 31st March in each year in London is about 4,000,000*l.*, more than half of this being needed to meet

the necessary payments for interest on debt at the beginning of April. When the annual budget is drawn up the Government of India make an estimate of the amount of Council drafts that they will be able to meet from time to time throughout the year. The India Office on the basis of this estimate frame a ways and means budget for the home charges, and arrange to borrow in some form or other the amount required to balance their account. They usually frame their budget, unless for special reasons, so as to estimate for a closing balance at the end of the year of about 4,000,000*l*. If the actual closing balance of the year which is ending is likely to be very much in excess of 4,000,000*l*. they reduce their estimate of borrowings or increase their estimate of capital expenditure for the new year, so as to bring the closing balance of the latter year down to about the normal figure.

190. As the demand for remittance to India is active mainly in the Indian busy season, the greater part of the receipts from Council drafts can only be expected to accrue towards the end of the financial year. The borrowing contemplated in the budget therefore necessarily takes place before it is known how closely the actual receipts will agree with the estimates. Moreover, it is generally recognised that the London money market is more favourable to borrowers in the first half of the calendar year. The India Office accordingly borrow the amount budgetted for either in the first months of the financial year, or sometimes, when market conditions are favourable, as early as February or March in advance of the new financial year. Under existing conditions, therefore, it is impossible for the India Office to regulate their borrowings for the needs of the year in accordance with the surplus or deficit over estimate of their receipts from Council drafts. If, as has happened recently, these receipts exceed the estimate by 10,000,000*l*. or more, the necessary result is that the closing balance of the year largely exceeds the normal 4,000,000*l*. These excess receipts have been due entirely to the recurrence of revenue surpluses in India and their transference to London, with both of which topics we have already dealt. We need only observe, therefore, in regard to the recent accumulation of high balances in London, that a change in the date of the commencement of the financial year, such as we have suggested, would have the further advantage of enabling the India Office to fix the time and amount of their borrowings in London with a more accurate knowledge of their real requirements.

191. Some criticism has been directed against the India Office for not using a larger part of these balances for the discharge of debt. India being a constant borrower for reproductive capital expenditure, the policy of the Government has been, in our opinion rightly, to use their surpluses not in repayment of permanent debt but in the reduction or avoidance of fresh borrowing. We do not agree with those critics who would have advocated the repayment of permanent debt out of the large balances in the years 1910 to 1912, with the result that fresh borrowing would have been requisite soon after. As we have already explained, the continuance of such high balances was not foreseen by the India Office, which necessarily relied on the accuracy of the Government of India's forecasts.

192. But we are inclined to think that in their dealings with the temporary debt the India Office, like the Government of India, are open to the charge of being over-cautious We would instance in particular the renewal of 1,500,000*l*. of India bills in December 1910 and again in December 1911. The fact that the summer monsoon was over and the probability of some considerable surplus in the receipts from sales of Council drafts could be foreseen by that period of the year would have justified, we think, a less cautious procedure. Another particular instance of what appears to us to have been excessive caution is the flotation of a loan for 3,000,000*l*. in London in April 1912 when the market conditions were very unfavourable, regard being had to the size of the closing balance on 31st March 1912, viz., 18,390,013*l*.; and in looking into this transaction we have found some reason to doubt whether there is sufficiently close consultation between London and India as to the time and amount of particular borrowing operations. It is probable that in 1912 a larger amount than three crores might advantageously have been raised by a rupee loan in July and a smaller amount than 3,000,000*l*. by a sterling loan in London in April.

(6) Lending out of India Office Balance in London.

193. It remains to consider certain special features in the location and management of the India Office balance in London. Under an old-standing arrangement the India Office maintain a minimum balance of 500,000*l*. with the Bank of England

with which, under the Acts 21 & 22 Vict. c. 106, and 22 & 23 Vict. c. 41, the account of the Secretary of State in the United Kingdom is kept. A very small amount of cash is kept in the till of the Accountant-General at the India Office for daily needs, and some comparatively small amounts are generally held by sub-accountants of the India Office. The rest of the London balance is placed on temporary loan in the City of London.

194. The system of so placing the London balance dates from the time of the East India Company, and is thus an old-established one. A list is kept at the India Office of "Approved Borrowers," admission to which is obtained by application to the Secretary of State's broker, who communicates the application to the India Office. It has always been recognised as the special function of the chairman of the Finance Committee of Council to advise upon such applications. These applications must be considered by the Finance Committee as a whole, but are now submitted after confirmation by that body for the approval of the Secretary of State in Council. Questions as to the retention of a name on the list are similarly decided. Only firms or individuals of high standing are admitted, and a fixed maximum is laid down in each case for the amounts that may be lent to each borrower. Loans are made in sums of 50,000*l.* or multiples of 50,000*l.* Borrowers are required to deposit at the Bank of England securities of specified kinds against the loans made to them, these securities being transferred into the name or possession of the Secretary of State at the Bank before the loan is made. The full list of approved borrowers as at the 31st March 1913 will be found in Appendix XI.

195. The actual business of finding borrowers is done by the Secretary of State's broker acting under the general directions of the chairman of the Finance Committee. His duty is to place the money at his disposal at the best rate of interest which he can obtain, subject to the general rules already indicated as to the approval of the borrowers and the securities deposited. The appointment of the broker rests with the Secretary of State. The present broker, whose family has long been connected with this particular business, was appointed in 1903 on condition of his becoming a partner in an old-established firm of money-brokers; the appointment was at first for a term of two years, but was renewed in due course, and is now held at the Secretary of State's pleasure.

196. We are satisfied that the system is on the whole well managed, and we have had it in evidence that only in two cases in the last 20 years have borrowers been unable or unwilling to repay their loans on the dates on which they were due, and that in both these cases the Indian Exchequer suffered no ultimate loss. We are, however, of opinion that the facilities for obtaining loans and the method of obtaining admission to the list of approved borrowers might with advantage be made more widely known in the City. And we think that some change is needed in the regulations governing both the kind of securities which are accepted and the amount of cover, if any, required for each of the several classes into which the specified securities are divided.

197. The classification (as revised and extended in February and April 1913) is as follows (*see* Appendix XI., pp. 310 and 312 to 314):—

SECURITIES AUTHORISED FOR ACCEPTANCE.

India Debentures, India Bonds, and Guaranteed Debentures of the several Indian Railway Companies, are taken at their par value.

Treasury Bills, Exchequer Bills, Exchequer Bonds, India Sterling Bills, Metropolitan Water Board Bills, and London County Bills are accepted at their market value, instead of their nominal amount.

The following securities are accepted at their minimum market value, with a cover of 5 per cent., the cover being replaced if the value of the security falls during the currency of the loan:—

Any of the Parliamentary Stocks or Annuities of the United Kingdom.
India 3½ per cent., 3 per cent., or 2½ per cent. Stock, and Stock Certificates.
India Enfaced Rupee Paper.
Fully-paid Debenture Scrip of the Indian Guaranteed Railway Companies.
Any securities, the interest on which is, or shall be, guaranteed by Parliament.
Metropolitan Consolidated Stocks and Stock Certificates.
Metropolitan Police 3 per cent. Debenture Stock.
Metropolitan Water Board "B" Stock, and Stock Certificates.

London County Consolidated Stocks, Stock Certificates and Scrip.
Corporation of London Debentures.
Bonds or Bills of Colonial Governments that have observed the conditions prescribed in the Colonial Stock Act, 1900, 63 & 64 Vict. c. 62, and of British Municipalities with a population of 500,000 or upwards (at present Birmingham, Liverpool, Manchester, and Glasgow), provided that in each case there is an obligation to repay the principal of the bond or bill within a period not exceeding five years from the date on which the loan is granted.

198. We think that the practice of lending upon India debentures, India bonds, and guaranteed debentures of Indian railway companies at their par value, although the market value may be under par, is unsound. We observe that in the two cases in which borrowers were unable to meet their loans when they fell due the securities deposited consisted of railway debentures of this kind. It was argued by the India Office witnesses in favour of the practice that it enables the Indian Government to make their issues of new sterling capital on more favourable terms than would otherwise be the case. We are unable to attach much importance to this contention, and in any case we hold that the result obtained does not counterbalance the obvious objections to the course pursued.

199. On the other hand, we are of opinion that the list of approved securities is unduly narrow. We understand that the India Office consider themselves precluded from accepting as security for loans securities transferable elsewhere than at the Bank of England. We think this is unfortunate. We should like to see the list enlarged to cover similar securities registered elsewhere, and it is a matter for consideration whether in addition some of the best Trustee stocks not now in the list might not be accepted to a limited extent subject to the provision of ample cover. In any case it would seem that the narrow boundaries of the existing list needlessly increased the difficulties of the India Office in finding borrowers for the whole of the large balances held during 1910 and the following years, and though we do not feel competent ourselves to draw up a complete list and set of rules, we desire to draw the attention of the Secretary of State to the evidence we have received on the subject and to the considerations set out above.

200. The usual periods for loans to approved borrowers are from three to five weeks, or occasionally six weeks, according to the calculations of the Accountant-General as to the term within those limits for which the money can conveniently be spared. In practice, when large sums are available for lending, the same borrower keeps loans continuously for very much longer periods, through their renewal from time to time after the expiration of the first term. But the prevailing rate of interest has to be paid at each occasion of renewal, and there is no hesitation in requiring repayment if a borrower is unwilling to pay the rate demanded. The criticism has been made that by leaving loans with the same borrower for long periods the India Office have in effect been lending for a long time at rates appropriate only to short-term loans. It would certainly seem that the limit of six weeks is adhered to a little too rigidly, and that some unnecessary caution is exercised in this matter. For instance, no allowance is made, in fixing the dates on which loans are to be repayable, for the receipts likely to accrue from the sale of Council drafts during the interval. We recommend that the present rules should be relaxed whenever a favourable opportunity for lending for any longer period up to (say) three months coincides with ability to spare the money for so long. But it is important that the money should in all circumstances be kept readily available, since it represents a cash balance which should not be diverted from its primary functions for the sake of earning slightly higher rates of interest.

201. We have already alluded to the difficulties which were met with in placing out with approved borrowers the whole of the large balance held by the India Office in London in the years prior to 1913. It is stated that the broker finds himself unable as a rule to place more than from 10,000,000*l.* to 11,000,000*l.* with borrowers on the list under the rules to which he is required to conform. From June 1909 to December 1912 the total India Office balance was considerably higher than 11,000,000*l.* The broker was accordingly directed to place the remainder on deposit with certain specified London banks. The deposit was usually for a period of two months, but sums belonging to the Gold Standard Reserve were occasionally deposited in this way for three months.

202. In view of the fact that two successive chairmen of the Finance Committee and another member of that Committee were also members of the directorates of banks with which such deposits were made at a time when they held their appointments

at the India Office, and that unfavourable comment has been publicly made on this association, we have examined very carefully into the circumstances attending the making of these deposits. We find no ground whatever for the suggestion that the connection between members of the Finance Committee and certain of the banks led to any kind of favouritism being shown to those banks. The deposits were never made at anything less than the best rate of interest obtainable at the time they were made. There was no hesitation in removing a deposit from one bank to another if advantage could be secured by so doing. There is, therefore, no ground for criticism of the way in which this duty was discharged. But we think it advisable to call the attention of the Secretary of State to the importance of avoiding as far as possible all occasion for criticism of this nature, though it may be founded on prejudice and ignorance of the facts.

203. We understand that the charges made by the Bank of England for various services as well as the services themselves are at present under consideration and form the subject of correspondence between the Secretary of State and the Bank. We therefore confine ourselves to observing that in our opinion the time has come for a general review of the whole subject of the relations of the Bank of England with the India Office.

204. Owing to the large balances of the last few years, the remuneration of the India Office broker reached an unprecedented figure. The scale on which it was calculated was thereupon revised. We are not convinced that the principle at present followed of paying him in proportion to the amount of money handled and the rate of interest earned is right. It can hardly be said that the call upon his time varies in exact proportion to the amount of money handled, and after all allowance is made for his skill and zeal in seeking the best rate of interest available, the rate actually obtained must depend much more on the conditions of the money market than on his exertions. We suggest that the working of the present arrangement should be watched. If the balances fall very low, or if they again rise very high, it may require reconsideration. If the principle of a sliding scale be maintained, it would probably be desirable to fix a maximum above which and a minimum below which it should not rise or fall.

IV.—FINANCIAL ORGANISATION AND PROCEDURE OF THE INDIA OFFICE.

205. We have already had occasion to mention and comment upon certain details of the financial organisation and procedure of the India Office in connection with the sales of Council drafts and the system of lending out the cash balance of the India Office in London, and at the beginning of our Report we recorded our very high opinion of the way in which the financial work of the Government of India and of the India Office is performed by the permanent officials to whom it is entrusted. We propose in this section of our Report to confine ourselves to a consideration of general principles.

206. The organisation and procedure of the India Office are conditioned by its legal constitution under a Secretary of State and a Council. This system is necessarily somewhat cumbrous in matters of detail, but it appears to work well on the whole, and must be accepted as the basis of any scheme of organisation which we can consider. Our inquiry will therefore be directed first to the machinery used for bringing financial questions before Council, that is, to the constitution of the Finance Committee of Council, and second to that part of the permanent staff of the India Office which deals with finance.

(a) *Finance Committee of Council.*

207. In considering the constitution of the Finance Committee, we have had our attention drawn to the proposals for a reorganisation of the India Council, outlined by the present Secretary of State in a speech made by him in the House of Lords on the 31st July 1913 after this Commission had begun their sittings. The Secretary of State expressly reserved detailed consideration of his scheme so far as finance is concerned pending the report to be made by us on this portion of our terms of reference. The main features of his scheme are a reduction in the numbers of the Council and the abolition or modification of the Committee system, for which would be substituted a system resembling that already adopted in the Viceroy's Council,

under which particular members of Council would be closely attached to particular divisions of the India Office. In regard to finance this would mean the supersession, in whole or in part, of the Finance Committee and the appointment of one member of Council as Finance member at the head of the Financial Department.

208. In this proposal, so far as it affects financial matters, we cannot concur. We are of opinion that the financial work of the India Office, which involves many technical and difficult problems requiring for their consideration a combination of Indian experience with an expert acquaintance with the London money market, is of a kind for which the Committee system is specially suitable, and we think that the continuance of the Finance Committee in some form is most desirable. It has been suggested that it would be possible to provide for the necessary expert knowledge by means of a Committee of which the members need not all be members of Council. But we see very serious difficulties in the way of any such arrangement. It would seriously impair the status of the members themselves and would deprive them of the opportunity which they now enjoy of obtaining that general knowledge of Indian government and Indian affairs without which they would lose much of their usefulness and nearly all their authority. So far, therefore, as financial work is concerned we recommend the continuance of a Finance Committee of Council.

209. The Finance Committee as now constituted consists of five members of Council, two of whom are bankers connected with large banks in the City of London. These two members have no direct Indian experience. The three remaining members have Indian experience and the members of the Committee represent, in addition to Finance, the Army, Public Works, and General Administration. Since 1880, if not longer, it had been, up to the year 1911, the established practice to have always one member, without Indian experience, who was actively engaged in business in the City, and another with experience of non-official finance, commerce, or banking in India. Besides this, until the retirement of Mr. Finlay in 1906, there was, as a rule, at least one member who had held high financial office in or under the Government of India. Of the last four chairmen of the Committee, three have been City men without Indian experience, and the fourth was one who had been appointed as a representative of Indian commerce, but combined with this qualification an expert knowledge of the London money market.

210. The ideal constitution of the Finance Committee would, in our opinion, include three members with financial experience, two representing respectively Indian official finance and non-official Indian commerce and banking, and one representing the London money market. We see no reason why this ideal should not, as a rule, be attainable; but, if it should occasionally be otherwise, we are of opinion that in all circumstances there should be at least one member with Indian financial experience either official or non-official. We think there are advantages in having a man of Indian experience as chairman of the Finance Committee, but in this matter the Secretary of State should have absolute discretion to appoint the person best suited for the post.

211. It appears to us, in connection with this subject, to be a matter for consideration whether the present pay and tenure of a member of Council are sufficient to attract the best class of financial advisers, more especially in the case of those possessing Indian experience. Until the year 1907 the salary was 1,200*l.* and the tenure of office was for ten years. The salary is now 1,000*l.* and the tenure is for seven years. Considering the immense importance to India of securing the best possible advice and assistance in these financial matters, we cannot help thinking that the advantages now offered may be inadequate. If that be so, they should be increased.

212. We should deprecate any rule which would have the effect of preventing men actively engaged in business in the City from joining the Council. We are aware of the objections which may be raised, and, as a matter of fact, have been raised, to the present practice; but we consider that they are far outweighed by the advantage of having as a financial adviser a man of the highest standing and repute in daily touch with the money market; and we should see with regret any restrictions which would confine the choice of the Secretary of State to "those who," to use a classical phrase, "have retired from business, or those from whom business has retired."

213. We are fully satisfied that both in the past and at the present time the City of London representatives on the Finance Committee have always kept the

interests of India clearly in view, and have performed the duties of their office solely with regard to the welfare of India. But recent political and social changes in India have led to an increasingly close scrutiny in India of the Government's financial administration, and have added very greatly to the amount and the importance of the criticisms which are directed in India against that administration. Moreover, these criticisms now find expression in the form of questions in the Legislative Council which have to be answered by the Government representatives. It appears to us to be hardly compatible with the new conditions in India that just at this time an alteration should have been made in the composition of the India Council and the Finance Committee, involving the omission therefrom of any representation of Indian financial experience, whether official or non-official. The result has been to give the representation of London City experience a position of undue prominence in the Finance Committee, which is, in our opinion, undesirable.

214. We understand that one of the principal objects of the proposals for the reorganisation of the India Council is to expedite business. We think that there is room for improvement in this respect in the financial sphere with which alone we are concerned. But we attach importance to the discussion of all large questions of finance in Finance Committee whenever time admits of it; and the powers of the Secretary of State in respect of the despatch of business are such that he can generally secure such discussion without any undue delay. The Secretary of State has already confided large discretionary powers to the chairman, and these will no doubt be continued, and will enable him to act, either alone or with the special sanction of the Secretary of State, whenever prompt measures are necessary. We desire, however, to make it clear that, subject to the conditions which we have laid down in this and the preceding paragraphs, we should welcome any changes, whether requiring legislative sanction or not, which would simplify financial procedure and prevent unnecessary delay in the consideration and determination of questions of a financial character.

(b) *Permanent Staff of the India Office.*

215. At the head of the Financial Department of the India Office, but subordinate to the Permanent Under Secretary of State and to the Assistant Under Secretary, is the Financial Secretary, upon whom fall the main burden and responsibility for the financial work of the office. At the present time it happens that the Assistant Under Secretary of State is an officer trained in the Financial Department and equipped with extensive knowledge of finance. He is thus able to offer useful advice to the Financial Secretary in the many cases in which a second opinion is desirable, and considerably to lighten his burden and responsibility. It is also possible to focus in the hands of the Assistant Under Secretary the consideration of financial questions originating in divisions other than the Financial Department and submitted to the higher authorities by the heads of those divisions. This arrangement has obvious advantages, and has served to relieve the Financial Secretary, who, until it was adopted, was undeniably overworked.

216. It appears to us that a return to the previous system, which threw the whole burden of supplying special financial knowledge and criticism upon the Financial Secretary, is, if not impossible, certainly undesirable. For the future, it has been suggested either (1) that the Under Secretary of State or the Assistant Under Secretary should have financial experience; or (2) that there should be two Assistant Under Secretaries, of whom one should have had financial training. As between these alternatives we are unwilling to express an opinion, believing that the choice must depend largely upon the varying circumstances of the time and on the material at the disposal of the Secretary of State. We are content to record our opinion that, in one or other of these ways, the burden of work and responsibility which previously fell upon the Financial Secretary should continue to be diminished, as it is under the existing arrangement. It has also been suggested that the Financial Department should be strengthened by the appointment of a second Financial Secretary, to whom business of a technically financial character should be specially allotted. We bring this suggestion to the attention of the Secretary of State.

The pecuniary value to India of the efficient performance of the financial business of the India Office is very great and would amply justify any extra cost in salaries that might arise from the adoption of our recommendations.

V.—STATE OR CENTRAL BANK.

217. We have made no reference to the State Bank question in the earlier passages of our Report, in spite of its frequent relevance, because we were unwilling to introduce, in passing, remarks which might appear to prejudge, one way or the other, a question which we were not prepared to discuss in detail. Many of our recommendations, notably those which relate to the maintenance of exchange, the position of gold in the currency, the system of budgetting, and the raising of loans by Government, are not appreciably affected by any decision which may be arrived at on the bank question. But others, especially those which relate to the elasticity and fiduciary portion of the note issue, to the custody, employment, and proper amount of the Government balances in India and London, and to remittance, are somewhat intimately bound up with the presence or absence of a State bank. The bank question has also a close connection with subjects not directly falling within the terms of our reference, such as the absence of a final banking reserve in India and the question of giving the Presidency banks access to London, the extension of co-operative credit in India, the improvement of banking facilities and the encouragement of sound banking in that country.

218. It has been represented to us that, under several of these heads, the difficulties and inconveniences which arise are largely contingent on the absence of a strong central banking institution, competent to manage the note issue, and so constituted as to be in a position to hold and manage the whole of the Government balances and to transact for Government other business naturally falling within the province of the Government's banker, such as remittance. In the lack of such an institution the Government of India's position, while not unexampled, is unusual. So long as the Government remain aloof from banking, so long as they maintain (to any important extent) an independent treasury system, and so long as the management of the note issue is kept outside banking, some features of the present system, which may be regarded as anomalous, will remain. We have endeavoured in the preceding parts of our Report to make such recommendations as will permit the continuance of these features with as little general inconvenience as possible. But those which relate to the note issue and to the employment of balances may be regarded, from one point of view, as palliatives rather than cures.

219. We have been naturally led, therefore, to give some consideration to the possibility of such more radical changes as are contingent on the establishment of a State bank—a proposal which presents at the same time some attractive features and some obvious practical difficulties. But we found from the outset in examining witnesses upon the subject of a State or Central Bank that the absence of anything in the nature of concrete proposals and even of any general agreement as to what was implied by the phrase "a State or Central Bank" made such examination difficult and unsatisfactory. It was arranged, therefore, before we adjourned for the summer holiday in August, that two of our number, Sir Ernest Cable and Mr. J. M. Keynes, should prepare a detailed scheme for their colleagues' consideration. We annex to our Report the memorandum submitted to us by Mr. Keynes, after collaboration with Sir Ernest Cable, in accordance with this decision.

220. We had previously received the memorandum on the subject of a State Bank or Central Bank submitted to us by Mr. L. Abrahams, C.B., with the concurrence of the Secretary of State. This memorandum was printed as Appendix No. XIV. to our Interim Report. The memoranda in question indicate most of the advantages and disadvantages attaching to the proposal on general grounds and the considerations to be borne in mind in dealing with it. It is unnecessary for us to recapitulate them here.

221. A study of these two memoranda makes much clearer the nature of the questions at issue; and the schemes proposed in them present *primâ facie* several attractive features. But most of the witnesses whom we have examined had not been in a position to consider or pronounce upon the specific proposals therein contained. It was not possible for us, therefore, to submit these schemes to a sufficiently searching examination without much delay in the presentation of our Report. We recognised, further, that such an examination would probably involve a visit to India and a careful study of the conditions on the spot, and we came to the conclusion that we were not fitted as a body to undertake this task. We do not feel ourselves, therefore, in a position to make recommendations, one way or the other, on the question of a State Bank.

222. But we regard the question, whatever decision may ultimately be arrived at upon it, as one of great importance to India, which deserves the careful and early consideration of the Secretary of State and the Government of India. We think, therefore, that they would do well to hold an inquiry into it without delay, and to appoint for this purpose a small expert body, representative both of official and non-official experience, with directions to study the whole question in India in consultation with the persons and bodies primarily interested, such as the Presidency banks, and either to pronounce definitely against the desirability of the establishment of a State or Central Bank in India at the present time, or to submit to the authorities a concrete scheme for the establishment of such a bank fully worked out in all its details and capable of immediate application.

VI.—SUMMARY OF CONCLUSIONS.

223. For convenience of reference we summarise our conclusions as follows :—

(i) The establishment of the exchange value of the rupee on a stable basis has been and is of the first importance to India. (Para. 8.)

(ii) The measures adopted for the maintenance of the exchange value of the rupee have been necessarily and rightly rather supplementary to, than in all respects directly in pursuance of, the recommendations of the Committee of 1898. (Paras. 7 and 44 to 46.)

(iii) These measures worked well in the crisis of 1907-8, the only occasion upon which they have been severely tested hitherto. (Paras. 48, 49.)

(iv) The time has now arrived for a reconsideration of the ultimate goal of the Indian Currency system. The belief of the Committee of 1898 was that a Gold Currency in active circulation is an essential condition of the maintenance of the Gold Standard in India, but the history of the last 15 years shows that the Gold Standard has been firmly secured without this condition. (Paras. 47, 50.)

(v) It would not be to India's advantage to encourage an increased use of gold in the internal circulation. (Para. 64.)

(vi) The people of India neither desire nor need any considerable amount of gold for circulation as currency, and the currency most generally suitable for the internal needs of India consists of rupees and notes. (Paras. 55, 76.)

(vii) A mint for the coinage of gold is not needed for purposes of currency or exchange, but if Indian sentiment genuinely demands it and the Government of India are prepared to incur the expense, there is no objection in principle to its establishment either from the Indian or from the Imperial standpoint: provided that the coin minted is the sovereign (or the half-sovereign); and it is pre-eminently a question in which Indian sentiment should prevail. (Paras. 69–73.)

(viii) If a mint for the coinage of gold is not established, refined gold should be received at the Bombay Mint in exchange for currency. (Para. 73.)

(ix) The Government should continue to aim at giving the people the form of currency which they demand, whether rupees, notes, or gold, but the use of notes should be encouraged. (Para. 76.)

(x) The essential point is that this internal currency should be supported for exchange purposes by a thoroughly adequate reserve of gold and sterling. (Para. 76.)

(xi) No limit can at present be fixed to the amount up to which the Gold Standard Reserve should be accumulated. (Para. 86.)

(xii) The profits on coinage of rupees should for the present continue to be credited exclusively to the Reserve. (Para. 89.)

(xiii) A much larger proportion of the Reserve should be held in actual gold. By an exchange of assets between this Reserve and the Paper Currency Reserve, a total of about 10,000,000*l.* in gold can be at once secured. This total should be raised as opportunity offers to 15,000,000*l.*, and thereafter the authorities should aim at keeping one-half of the total Reserve in actual gold. (Paras. 93 to 100.)

(xiv) The Indian branch of the Gold Standard Reserve in which rupees are now held should be abolished, the rupees being handed over to the Paper Currency Reserve in exchange for gold. (Para. 98.)

(xv) The proper place for the location of the whole of the Gold Standard Reserve is London. (Paras. 90 and 100.)

(xvi) The Government should definitely undertake to sell bills in India on London at the rate of 1*s.* $3\frac{29}{32}$*d.* per rupee whenever called upon to do so. (Para. 101.)

(xvii) The Paper Currency system of India should be made more elastic. The fiduciary portion of the note issue should be increased at once from 14 crores to 20 crores, and thereafter fixed at a maximum of the amount of notes held by Government in the Reserve Treasuries *plus* one-third of the net circulation, and the Government should take power to make temporary investments or loans from the fiduciary portion within this maximum in India and in London, as an alternative to investment in permanent securities. (Paras. 112 and 113.)

(xviii) We recommend the immediate universalisation of the 500-rupee note and the increase of the facilities for the encashment of notes. (Para. 115.)

(xix) The aggregate balances in India and London in recent years have been unusually large. This has been due mainly, though not entirely, to accidental causes and to the exceptional prosperity of India. (Paras. 125, 126.)

(xx) Caution is justifiable in framing Budgets in India, but has been carried rather further than was necessary in recent years. (Paras. 126 and 128.)

(xxi) A change in the date of the commencement of the financial year from the 1st April to the 1st November or the 1st January would probably enable the Government of India to frame more accurate Budgets. Such a change would also enable the India Office to fix the amount of their borrowings in London with closer regard to immediate needs. We commend this proposal for favourable consideration. (Paras. 128 and 190.)

(xxii) The practice of transferring revenue surpluses to London to be used in avoiding or reducing fresh borrowings for capital expenditure has been thoroughly justified in the interests of India, and the Secretary of State has made good use, for this purpose or for actual reduction of debt, of the balances from time to time accumulated in his hands. (Paras. 130 to 133 and 179.)

(xxiii) But the recommendations which we make as regards loans by Government in India may lead to a revision of the occasions, though not of the extent, of transfers of money to London. (Para. 133.)

(xxiv) The independent Treasury system of the Indian Government is not an ideal one. It is partly responsible for the stringency which recurs annually in the Indian money markets. (Paras. 137 to 143.)

(xxv) We recommend that the Government of India should make a regular practice of granting loans to the Presidency Banks from their surplus balances in India against security on terms to be negotiated with the Presidency Banks. (Paras. 150, 163, 164.)

(xxvi) In deciding upon the location of surplus balances, the Government of India and the Secretary of State should act in consultation, and, while the transmission of the necessary funds to London at favourable rates of exchange is the first consideration, the authorities should have regard to all the factors including the possibility of utilising surplus balances for loans in India. (Paras. 159 to 161.)

(xxvii) In carrying out these recommendations, the authorities should proceed tentatively and with caution. (Para. 165.)

(xxviii) We recommend that the amount of the annual rupee loans in India should be increased as much as possible. The figures of recent loans appear to have been somewhat over cautious. We call attention to the questions of relaxing present regulations in regard to endorsements on rupee paper and of creating new forms of securities. (Paras. 167 to 169.)

(xxix) The Secretary of State sells Council Drafts, not for the convenience of trade, but to provide the funds needed in London to meet the requirements of the Secretary of State on India's behalf. (Para. 186.)

(xxx) The India Office perhaps sold Council Drafts unnecessarily at very low rates on occasions when the London balance was in no need of replenishment, but we do not recommend any restrictions upon the absolute discretion of the Secretary of State as to the amount of drafts sold or the rate at which they are sold, provided that it is within the gold points. The amount and occasion of sales should be fixed with reference to the urgency of the Government's requirements and the rate of exchange obtainable, whether the drafts are against Treasury balances or against the Reserves. (Paras. 181 to 185.)

(xxxi) There has been some excess of caution in the renewal of debt by the India Office during recent years. (Para. 192.)

(xxxii) The system of placing portions of the India Office balance out on short loan with approved borrowers in the City of London is on the whole well managed, but we draw attention to—

(*a*) The term for which loans are made.

(*b*) The desirability of giving greater publicity to the methods by which admission is gained to the list of approved borrowers.

(*c*) Some defects in the list of approved securities and especially its narrow range. (Paras. 196 to 200.)

(xxxiii) There is no ground for the suggestion that the City members of the Secretary of State's Council showed any kind of favouritism in placing on deposit with certain banks, with the directorates of which they were connected, a part of the India Office balance at a time when it was too large to be placed entirely with the approved borrowers. But we call the attention of the Secretary of State to the desirability of avoiding as far as possible all occasion for such criticism, though it may be founded on prejudice and ignorance of the facts. (Para. 202.)

(xxxiv) We observe that in our opinion the time has come for a general review of the relations of the India Office to the Bank of England. (Para. 203.)

(xxxv) The working of the present arrangements for the remuneration of the Secretary of State's broker should be watched, and if necessary they should be revised. (Para. 204.)

(xxxvi) We record our high opinion of the way in which the permanent staff, both in India and in London, have performed the complicated and difficult financial duties placed upon them. (Para. 7.)

(xxxvii) We recommend a continuance of a Finance Committee of Council as providing the machinery most suitable for the work required. (Para. 208.)

(xxxviii) The Finance Committee should, if possible, contain three members with financial experience, representing—

(*a*) Indian Official Finance.
(*b*) Indian Banking and Commerce.
(*c*) The London Money Market.

In any case there should be at least one member with Indian financial experience. The absence of any representative of Indian finance on the Committee since 1911 has resulted in giving undue prominence to the representation of London City experience. (Para. 210.)

(xxxix) While we suggest that the changes recently proposed and now under discussion in the constitution of the India Council may require some modification in order to provide for the continuance of a Finance Committee of Council, we are in sympathy with the desire for expediting financial business, which is one of the objects in view. (Para. 214.)

(xl) The present arrangement under which the Assistant Under Secretary of State, having financial experience, is able to share with the Financial Secretary the responsibility for financial business in the India Office has many advantages. For the future we recommend that either (1) the Under Secretary or Assistant Under Secretary of State should have

financial experience as at present, or (2) there should be two Assistant Under Secretaries, of whom one should have financial experience. (Para. 216.)

(xli) We are not in a position to report either for or against the establishment of a State or Central Bank, but we regard the subject as one which deserves early and careful consideration, and suggest the appointment of a small expert committee to examine the whole question in India, and either to pronounce against the proposal or to work out in full detail a concrete scheme capable of immediate adoption. (Paras. 221, 222.)

224. We desire to place on record our high appreciation of the valuable assistance which we have received from Mr. Blackett and Mr. Smith in the course of our inquiry. To Mr. Blackett in particular we have entrusted a great deal of extremely important work, and he has discharged the duties imposed upon him with great ability and unfailing courtesy and tact.

AUSTEN CHAMBERLAIN (*Chairman*).
FABER.
KILBRACKEN.
ROBERT CHALMERS.
ERNEST CABLE.
S. B. BROACHA.
J. BEGBIE.*
R. W. GILLAN.
H. N. GLADSTONE.
J. M. KEYNES.

BASIL P. BLACKETT,
Secretary.

Dated the 24th day of February 1914.

* Subject to note on p. 88.

ANNEXE TO REPORT OF ROYAL COMMISSION ON INDIAN FINANCE AND CURRENCY.

MEMORANDUM BY MR. J. M. KEYNES ON PROPOSALS FOR THE ESTABLISHMENT OF A STATE BANK IN INDIA.

CONTENTS.

[This memorandum was drawn up in the summer of 1913 by Mr. J. M. Keynes, in collaboration with Sir Ernest Cable, at the request of their colleagues on the Royal Commission. It retains a form originally designed with a view to the private use of the Commission rather than to publication, and in a few passages where its subject overlaps with that of the Report it shows the influence of some conclusions tentatively reached by the Commission in the summer.]

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MEMORANDUM ON PROPOSALS FOR THE ESTABLISHMENT OF A STATE BANK IN INDIA.

I.

INTRODUCTORY.

A Central Bank must necessarily stand in a somewhat close relation to Government. If the Bank is to be useful, it must have the management of the Government balances and of the note issue. It would be contrary to experience elsewhere and to what seems reasonable for India to hand over these functions to a purely private institution. If Government is to interfere at all, it cannot help involving itself in ultimate responsibility for the Bank, and if it is thus to involve itself, its powers must be sufficient to permit an effective supervision. From a Government with feeble powers and placed in the position of interested but irresponsible critics, there would be a greater likelihood of vexatious interference; while too great a dependence on the terms of the Bank's charter must tend to make these terms rigid and narrow for practice.

The constitutions of the principal State Banks of Europe and of the Bank of Japan are briefly outlined in an appendix to this Memorandum. Their general character points overwhelmingly to the conclusion that the higher executive officers responsible for the policy and administration of the Bank must be appointed by Government and rest under its ultimate authority. In all State Banks of importance the influence of the shareholders is chiefly consultative and advisory.

If these preliminary points are granted, we are at once faced with a somewhat different proposal from that which the Government had before them in 1900–1902. The position at that time seems to have been that, if the Presidency Banks would amalgamate on their own initiative and also increase their capital by a substantial amount, the Government would seriously consider the handing over to them, on terms to be discussed later, of the management of the paper currency and the use of a large portion of the public balances. The advantages to be gained by the Presidency Banks were insufficiently certain or precise, and the proposals fell through. Several of the difficulties which have appeared serious to some of our witnesses are more relevant, I think, to the proposals of 1900–1902 and to the popular idea of a State Bank thus fostered than to the proposals to be developed below.

The question why anyone should wish to set up a State Bank and the advantages to be got from it are treated in section VIII. Section II. is devoted solely to the problem whether it is feasible to devise for such a Bank a working constitution.

The main difficulties to be faced are the following:—

(i) To combine ultimate Government responsibility with a high degree of day-to-day independence for the authorities of the Bank.

(ii) To preserve unimpaired authority in the executive officers of the Bank, whose duty it would be to take a broad and not always a purely commercial view of policy, and at the same time to make use of the commercial instincts and commercial knowledge of representatives of the shareholders.

(iii) To maintain in the day-to-day management of the Bank the high degree of decentralisation to which great importance is rightly attached in the case of so large a country as India.*

Further points, such as the *status* of the Bank in London, the method of regulation of the note issue, the division of profits between the shareholders and the Government, no doubt present difficulties. But these must certainly

* As the Government of India wrote to the Secretary of State when advocating the establishment of a Central Bank (January 18, 1900):—"Nothing would be more unwise than "to discard the valuable local knowledge, skill and experience of the existing directorates and "managements of the Presidency Banks."

be capable of some solution. Fundamental objections to the proposed Bank must arise out of its failure to satisfy the three main conditions set out above.

An outline constitution so far as affects these three fundamental points is given below.

II.

OUTLINE CONSTITUTION, SO FAR AS CONCERNS THE RELATION OF THE BANK TO GOVERNMENT, THE POWERS OF THE SHAREHOLDERS, AND DECENTRALISATION.

1. The supreme direction of the Imperial Bank of India shall be vested in a Central Board of three members, consisting of the Governor of the Bank (who shall be Chairman), the Deputy Governor, and a representative of Government, together with three or more Assessors.

2. The Governor shall be appointed for periods of 5 years (subject to age limit) by the King on the recommendation of the Secretary of State, and shall be removable in like manner. He shall be eligible for re-appointment. The salary of the Governor shall be Rs. 100,000 per annum.*

3. The representative of Government shall be appointed by the Viceroy, and shall be, in general, the Financial Member of the Viceroy's Council, the Member for Commerce and Industry, or the Secretary from the Department of one of them.†

4. The Assessors shall be the Managers of the three Presidency Head Offices (*see* below) and of such other Head Offices as may be created hereafter, or their Deputies. The Assessors shall have the right to attend any meeting of the Central Board and to lay their views before it, but shall not vote. The Central Board shall also have the right to summon any of the Assessors to attendance.

5. The Deputy Governor of the Bank, and Managers of the Presidency Head Offices, who shall all be of the same status and receive salaries of Rs. 60,000* shall be appointed by the Viceroy on the nomination of the Governor of the Bank and of the Government representative on the Central Board. But the appointment of a Manager to a Presidency Head Office shall be subject to the approval of the Presidency Board (including representatives of the shareholders) of the Head Office in question.

6. Within the limits of the Bank Act, the Central Board shall have absolute authority, and the signature of the Governor supported by a majority vote of the Board shall be legally binding upon the Bank; save that the representative of the Government shall have discretionary power (for use in emergencies only) to suspend the carrying into effect of any decision until it has been reported to the Viceroy, with whom shall lie an ultimate right of veto.

7. The Central Board, which will have no direct dealings with the public, shall have its offices and establishment located at Delhi (or Calcutta). Its members will keep in touch with the chief commercial centres of the country, partly by the attendance from time to time of the Assessors, and partly by touring on the part of the Governor or his Deputy.

8. All transactions between the Bank and the public in India shall be under the authority of one or other of the Head Offices. In the first instance, Presidency Head Offices shall be established at Calcutta, Bombay and Madras, and the spheres of influence of these Head Offices shall be the same as those of the existing Presidency Banks.‡

9. Each Head Office shall be under the direction of a Presidency Board, consisting of the Manager (who shall be Chairman and have the casting vote), the Deputy Manager, a representative of the Local Government, and three (or four) unofficial members.

* These figures are put forward very tentatively, to suggest the status of the officers affected

† Or the Comptroller of Currency, the proposed appointment of whom has been lately announced.

‡ Including Ceylon, as at present in the case of the Madras Head Office.

10. The unofficial members shall be elected by the shareholders on the local register of each Presidency from amongst their own number.

11. Any business, within the limits of the Bank Act, and not contrary to the express instructions of the Central Board, entered into by a Presidency Board, shall be legally binding on the Bank.

12. Although the Central Board shall have authority to issue instructions, to which the Presidency Boards shall be subject, on all matters, nevertheless in general, and failing special prior instructions to the contrary, a Presidency Board shall have entire discretion to transact on its own authority all business of the following descriptions:—

(1) To discount Indian (rupee) trade bills, maturing within a maximum period of six months, subject to a minimum rate arranged from time to time in consultation with the Central Board;
(2) To rediscount sterling trade bills, bearing the endorsement of another bank, subject to minimum rate arranged from time to time in consultation with the Central Board, and subject to daily report to the Central Board.
(3) To make interest-bearing loans (subject to a minimum rate, &c.), for periods not exceeding six months against such kind of security as is permitted by the Bank Act.
(4) To buy and sell in India, subject to daily report to the Central Board, gold bullion and such bonds and securities as may be dealt in according to the provisions of the Bank Act.
(5) To provide trade-remittance for customers to all parts of India, and private remittance to London subject to certain conditions.
(6) To accept interest and non-interest bearing deposits, subject to a maximum rate, &c.
(7) To accept valuable goods for safe keeping.
(8) To open, staff, and control branch banks at any place within the Presidency Board's sphere of influence.

13. A general report on all such transactions shall be forwarded to the Central Board weekly, and more frequently when the Presidency Board think it desirable, or the Central Board request it.

14. In regard to the rates charged for discounts and loans, and allowed on deposits the Presidency Boards shall be free to vary the rate charged in individual transactions and at their different branches, subject to minimum (or maximum) rates, fixed weekly (or in emergency more frequently) in consultation with the Central Board.

III.

DISCUSSION OF THE OUTLINE CONSTITUTION.

The object of the above draft proposals is merely to indicate in a more precise way than is otherwise possible the kind of relations which are contemplated between the Government, the Central Board, the Presidency Boards, and the shareholders. It will be worth while to discuss these points more fully and to consider also how far such proposals satisfy the three fundamental conditions which were laid down in I.

1. First, as regards the relation of the Bank to the Government. The creation of such a bank as is here proposed certainly increases in a sense the responsibilities of Government. But there are two senses of the term "responsibility." The Government may be said to be responsible if, in the last resort, it is the Government that has to come to the rescue. Or it may be held that it can only be called responsible if, in addition to this, it is the proper object of criticism or blame if anything goes wrong. Those acquainted with the present banking position in India would maintain, I think, that the Government already possesses responsibility in the first and more important sense. So long as they manage the note issue, and maintain large cash balances outside the ordinary banking system, they are bound to come to the rescue of the Presidency Banks in the event of a widespread crisis involving the banks generally.

The prevention of occurrences contrary to the public interest, rather than the avoidance of responsibility, ought in general to be the first object

of Government. The only good reason for avoiding responsibility in the first sense is in the case of kinds of action which Governments are not competent or have not the machinery to perform well; and the only good reason for avoiding it in the second sense, when it already exists in the first, is in cases where explicit responsibility would involve them in such unpopularity or criticism as might impair their general efficiency. It cannot be maintained that some responsibility for banking, seeing that it is in fact undertaken by nearly all civilised Governments, is inherently undesirable. The undesirable features in the Government's present degree of responsibility for these things in India are rather due to the lack of a suitable machinery. I need not enlarge on this. There is an absence of trained experience and specialised knowledge on the part of those responsible, so that financial duties are apt to be thrown on officers concerned, during the greater part of their careers, with quite other things. The business is of a kind where immediate action and undivided responsibility in regard to details is essential, whereas, if it is dealt with in the ordinary mills of Government, this is nearly impossible. But given a suitable machinery I do not see why anyone should wish to divest Government of the duties in question. That the solution lies in the provision of a more suitable machinery, rather than in the getting rid of existing functions, has been strongly impressed on me in the course of the Commission's deliberations. This more suitable machinery the creation of a State Bank affords.

It seems clear that Government cannot entrust any of its existing duties to private hands. It has also become plain that, whether a State Bank is established or not, Government, so far from relinquishing old duties, must bend itself to new ones. The functions of the note issue, it is generally agreed, must be extended, and an element of discretion must be introduced where there was previously none. As in the case of the note issue, so in the case of the cash balances, there must be less rigidity of rule and more discretion. Now, with a State Bank all this would be easy, and there are plenty of precedents to look to; but as soon as an attempt is made to work out precisely by what sort of procedure these objects are to be attained in the absence of a State Bank, it becomes apparent that it is not altogether through chance or obtuseness that such desirable changes have not been made long ago. The existing system has been deeply conditioned by the absence of a State Bank. The history of the management of the cash balances, for example, bears witness to this. At no time has anyone supposed the existing system to be perfectly satisfactory. It has established itself because it is the only system which frees the officials from the exercise of a discretion for which they do not feel themselves competent and from which they therefore shrink. The evidence is that actual practice has always tended to be more rigid than the actual letter of the rule laid down by the Secretary of State; and naturally enough. Similarly in regard to the paper currency. In the first instance, no doubt, the system was set up in uncritical imitation of the Bank of England's, and under the influence of the theory that it was a positive advantage for note issue to be separated from banking; but for 30 years at least this theory has lacked vitality or offspring, and note issue in India has remained divorced from banking because there has been no bank to join it to, and because, for a rule-of-thumb system, it is a fairly good one.

The choice lies between a good deal of responsibility *without* thoroughly satisfactory machinery for the discharge of it; and a little more responsibility *with* such a machinery. The balance of advantage is with the second alternative.

As regards the Secretary of State's exposure to pressure or parliamentary criticism of an undesirable kind, the creation of a State Bank would, without question, improve and strengthen his position. Recent experience shows that he cannot, under the present system, resist cross-examination on minute details of financial management. If arrangements are introduced for loans from the cash balances and for some degree of regulation of the currency reserve by discretion, will he not be liable to all kinds of questions in Parliament on details of executive policy? If the Government of India is lending three crores from the cash balances and some business men think they would like four crores, what will there be to prevent the working up of a strong agitation by means of the Press, daily fed and

inflamed by questions in the House, for lending on a larger scale? I do not see how the Secretary of State could be more exposed than he is to what may really be a most undesirable thing, namely, cross-examination on actions which are, in truth, none of his business.

The State Bank, on the other hand, would have a high degree of independence; and there would be numerous questions to which the Secretary of State's proper answer would be that it was entirely a matter for the Bank. He would never admit, for example, the faintest degree of responsibility for the precise level of the bank rate at a particular moment. The Secretary of State would be behind the Bank, but his authority would only come into play on rare and important occasions. On important changes of policy and on alterations of clauses in the Bank Act, the Secretary of State would have the last word and with it the responsibility. If over a period of time there were a widespread feeling that the regular administration of the Bank was ill-conducted, it would be his duty to grant an inquiry and to act in the light of its report. But for the ordinary daily work of the Bank he would necessarily disclaim responsibility to a far completer extent than is at present possible in the case of any of the financial business now conducted by the Government. The method of appointment suggested above of the Governor and Deputy Governor is intended not to make them Government officials, but to place them in a position of considerable independence. A State Bank would certainly act as a buffer of no little importance between the Secretary of State and external pressure of an undesirable kind.

This day-to-day independence of the Bank, which would incidentally prove a relief to the Secretary of State, would be absolutely essential from the Bank's own point of view. It is not likely that the commercial community would acquiesce in any proposal where it was absent. Banking business must be outside the regular Government machine, ignorant of "proper channels," and free of the official hierarchy where action cannot be taken until reference has been made to a higher authority. The officials of the Bank should have precisely the same powers for the prompt transaction of business that the officials of the Presidency Banks have now.

The presence of private capital is probably a considerable bulwark against some kinds of political pressure. Continental experience shows that private ownership of the Bank's capital, even although the shareholders have no more than advisory powers, is an important safeguard of the Bank's independence; and continental writers have laid great stress on this.*

The outline constitution given above has been designed with a view to these conditions. The Bank, though ultimately dependent on the State, would lie altogether outside the ordinary Government machine; and its executive officers would be free, on the one hand, from the administrative interference of Government and free also, on the other hand, from too much pressure on the part of the shareholders, in cases where this might run counter to the general interest.

A State Bank of the kind proposed might really get the best of both worlds. It is difficult to predict how a new institution will work out in practice. But the advantages of a State and of a private institution may be, partly at any rate, combined. Representatives of the public interest must have the ultimate control, because a State Bank is given powerful monopolistic rights; and the public interest may not invariably be at one with the interests of shareholders, though on the whole and generally speaking the shareholders must benefit largely by their connection with the State. On the other hand the alliance of the State with private shareholders serves to keep the executive of the Bank in close touch with commercial opinion, and introduces that element of commercial self-interest, from which, in the present economic arrangement of affairs, a State Bank, as well as private institutions, may derive a real advantage.†

* *See* Appendix B.

† The same point is emphasised in the following quotation from the official history of the Reichsbank:—"Through the co-operation of the Reichsbank authorities, who are not interested " in the financial profits of the Bank, with the representatives of the shareholders, who are " practical business men, the Bank management is safeguarded, since it takes into consideration " the interest of the public; and at the same time the experience and business knowledge of " the shareholders, who are financially interested in the success of the Bank, are utilised in the " guidance of the Bank. This bank organisation, which strikes the mean between a purely " State Bank and a purely private one, has proved to be the best system according to the " experience of most European countries."

It may be added in this connection that the Governor and Deputy Governor of the Bank should invariably be persons of commercial or banking, not of administrative or official, experience, and should be appointed, so far as may be possible or convenient from the staffs of the Presidency Offices. Though it would not be wise to lay down any rule or principle on the matter, and while it might be an advantageous thing to introduce from time to time officers whose banking experience had lain elsewhere, the Governorship of the Bank should be a position to which the leading officials of the Presidency Offices could reasonably look forward as a possible prize. It might, perhaps, increase public confidence in the non-official character of the Bank's management and in the Government's intentions, if it were definitely laid down that members of the English or the Indian Civil Service were ineligible for appointment as officers of the Bank.

2. Second, as regards the relation of the Central Board to the Presidency Boards, and the arrangements for decentralisation. We are here presented with a problem which is largely peculiar to India. But a little may be learnt from the organisation of the Head Offices of the Reichsbank described in Appendix A; and the establishment of local Committees or Directorates is fairly familiar in the case of many important banks doing business partly in London and partly abroad.

It is clear that the organism of the Central Board must be quite distinct from that of any of the Presidency Head Offices. It would be undesirable, *e.g.*, that the Calcutta Office should be superior in any way to the Bombay Office. The Presidency Boards and Presidency Offices must all be on a complete equality and stand in the same relation to the Central Board. Even if it proved convenient for the offices of the Central Board to be located in Calcutta, this Board would be quite distinct from the Bengal Presidency Board, just as the Imperial Government has been distinct from the Local Government of Bengal. This has not been a feature of earlier schemes, and the suggestion that one of the Presidency Offices would be in effect the Head Office of the whole Bank has been responsible for setting up local jealousies which the present scheme ought to avoid.

In the outline constitution given above, Delhi (or alternatively Calcutta) has been suggested as the headquarters of the Central Board. Delhi is open to a good deal of obvious criticism, but has, on the other hand, some advantages. To place the Central Board at Calcutta might lead to an undue overshadowing of the Bengal Presidency Board, as well as to a confusion in the public mind regarding the relation of the two Boards to one another. The suggestion of making the Calcutta Office the Head Office would no doubt commend itself to Calcutta interests. But there is no question of this; and it is doubtful whether local Calcutta interests would welcome a Central Board, on which Calcutta shareholders would not be directly represented, in immediate proximity and with superior powers to their own Presidency Board on which local interests have ample representation. To fix the Central Board at Delhi safeguards, on the one hand, its own impartiality and, on the other hand, the complete local independence of the Presidency Boards. This location would also facilitate the attendance of the Government representative,* and would be geographically convenient both for touring on the part of the officers of the Central Board, and for attendance at meetings on the part of the assessors from the local boards.

The chief objections to Delhi are, first, that this location would place the Bank too much under the direct influence of Government, and second, that the officers of the Bank would be too little in touch with commercial opinion. The first objection is obviously not capable of a precise answer and will appeal with varying force to different persons. But it may be pointed out that there is little reason for supposing that high authorities will wish to interest themselves in the Bank's daily transactions of which they will not, apart from the Government's representative on the Central Board, have any official cognisance at all; and that the Bank's independence

* It is understood, however, that the new Comptroller of Currency is to have his headquarters at Calcutta.

is considerably safeguarded by its constitution, and by the complete absence of connection with the Civil Service on the part of the Governor and Deputy Governor. The second objection is partly met by the following considerations. In the first place, the Central Board is to have no direct dealings whatever with the public, to whom, therefore, so far as the transaction of business is concerned, its location will be a matter of indifference. In the second place, the Central Board would rely for its knowledge of the commercial situation partly on the not infrequent touring of the Governor or Deputy Governor, and partly on the attendance at its meetings of the Managers of the Presidency Head Offices. Their knowledge of the *general* position would probably be more complete in this way than if they were permanently fixed at some one Presidency town. The fact that the busy seasons in different parts of India are to some extent distinct, emphasises the convenience of touring on the part of the Bank's highest executive officers.

The duties of the Central Board would be chiefly concerned with bank rate, with the remittance of funds from one Presidency to another, and between India and London, and with questions of general policy. But it might be advisable that they should also have directly under them an Inspection and Audit Department, not for the purpose of controlling the Presidency Boards and the various branches of the Bank, but as an independent check, after the event, on the nature of the business done, and as a means of rendering more actual the ultimate responsibility of the Central Board for all the Bank's transactions.

The position of the Presidency Managers in their capacity of Assessors to the Central Board requires further explanation. It would not be practicable to make them complete members of the Central Board, since this would imply more regular attendance at the Board's meetings than would be compatible with their duties at their own Head Offices. At the same time, it is desirable that they should be in close touch with the Central Board in person and not only by correspondence. The proposed scheme is intended to make it possible for them to attend the Central Board on occasions when they can conveniently be absent from their own office, and when they specially desire to place their views or proposals before the Central Board in person. The Central Board, on their part, would be able to convene from time to time meetings at which all the Presidency Managers would be, if possible, present. While the Central Board's offices and establishment must be fixed, there is no reason why the Board itself should not meet from time to time, if it should be found convenient, at various centres.

One of the main points to be emphasised regarding the relation of the Presidency Boards to the Central Board is that all questions of *individual* credit would be ordinarily within the discretion of the Presidency Boards. The general magnitude of the transactions of any kind must come within the cognisance and ultimate control of the Central Board. But the nature of the individual transactions making up the total, in general, should not. The Local Boards would thus possess substantial autonomy in the discount of inland bills and in the granting of advances. In all matters relating to individual credit they would possess the same independence as each Presidency Bank has now. They would also control the movement of funds within their own Presidency. They would, therefore, be able to conduct all ordinary business with members of the public with exactly the same degree of despatch as at present and without reference to higher authority.

3. Third, as regards the relation of the Bank to its shareholders. The chief points to be considered are the fair treatment of the shareholders in regard to their share of profits, the utilisation of the commercial knowledge and the commercial instincts of the shareholders' representatives, and the maintenance of the supreme authority of the Bank in the hands of officers who are not open to pressure on matters affecting public policy and the general good of the commercial and banking community.

The question of profits is treated in the next section of this Memorandum. The other two considerations are dealt with in the proposed scheme, on the one hand by constituting half (or, perhaps, a majority) of each of the Presidency Boards from representatives of the shareholders and by requiring the approval of these representatives to the appointment of the Managers of the Presidency Head Offices; and on the other hand by giving the shareholders no direct representation on the Central Board, though allowing them full opportunity of access to this Board and of laying their views before it through their local Managers. It might also be proper, as in the case of the Reichsbank, to distinguish certain questions, such as the drawing up of the annual balance sheet, on which special attention should be paid to the views of the shareholders' representatives.

Such limitation of the powers of the shareholders as is proposed in this scheme may appear to Indian opinion a somewhat novel feature which is open to criticism. But it is, I think, an unavoidable consequence of the great privileges and responsibilities of a State Bank, and does not go so far as in most of the State Banks of Europe and elsewhere.

IV.

CAPITALISATION OF THE BANK AND DIVISION OF PROFITS.

There is no question but that the nucleus of the new Bank is to be obtained by the amalgamation of the capital and reserves of the three Presidency Banks.

Continental experience suggests (*see* Appendix A) that it is probably inadvisable for the Government to subscribe any part of the capital of the Bank itself. Subscriptions from the Government are not necessary (*see* what is said below in regard to proposals for an increase of capital), and would complicate rather than simplify the relations between the Government and the shareholders.

It is proposed that the assets of the three existing Banks be taken over in the following manner:—

(1) The existing assets of the Banks to be accurately valued.*

(2) The reserves of each to be levelled, so as to bear the same ratio to their respective capitals, by reducing reserves and paying away the excess to the shareholders, or by increasing the reserves out of earnings as may be determined hereafter.†

(3) One share in the State Bank to be issued to shareholders for each share held in the Presidency Banks.

When this has been carried out, is any further increase of capital desirable? Earlier proposals for a Central Bank have attached a good deal of importance to an increase of capital. But this has probably been the case because these proposals have approached the question from a somewhat different point of view. The Government have often in the past given the low capitalisation of the Presidency Banks as a reason why they did not care to deposit a large part of their free balances with these banks. This objection was applicable in hardly less degree to a Central Bank which was merely an amalgamation of the existing Presidency Banks. Proposals for such a Central Bank were coupled, therefore, with proposals for an increase of capital. But the relation of the Government to the proposed State Bank will be such, that the additional guarantee which would be afforded by the subscription of further capital by the shareholders seems scarcely necessary. The advantage of the additional capital to Government would only arise in the case of the Bank's failure. In the event of so extreme a calamity, the loss by Government of 1,000,000*l*. more or less would be, relatively, of small consequence—the other results of such an occurrence would be so far more serious. The constitution of the Bank ought to ensure its being worked on such lines that the contingency of failure, in the sense of insufficiency of

* As they stand at present in the books of the Banks, the assets are almost certainly undervalued.

† This will present no practical difficulty, as the ratios of reserves to capital in the three Banks happen to be very nearly equal as it is.

assets to meet liabilities, is almost inconceivable. Moreover, if failure were to result, it must be admitted, I think, that the responsibility of Government would be so great that they could scarcely remove the whole of their balances intact, leaving to the shareholders the whole burden of the loss.

The only other reason for an increase of capital is lest the Bank should suffer from an insufficiency of working capital in its daily business. I doubt if this is likely to be the case. The capital and reserves under the above scheme would amount to 5,000,000*l*., and with the control of the paper currency and of the Government's cash balances the resources of the Bank would be very great.

If, however, it were held for any reason that some increase of capital was desirable, it would not be difficult to raise it. For example, new capital might be issued for 3¾ crores (doubling the existing capital) of which only 20 per cent. would be called up. The offer of such shares to the existing shareholders *pro rata* at a premium of (say) 100 per cent.* would be a valuable concession to them, or the issue may even be made at par if it is considered politic to offer great inducements. It may be assumed in either case that the shares would be taken up. While some such method as this might be advantageous if the object were to afford some additional guarantee for the deposits, an insufficiency of working capital might be best met by an issue of preference shares. Power could be taken in the Bank Act to issue 5 per cent. preference shares to a considerable amount, only to be issued by degrees, if and when required. Although the issue of preference shares may appear unusual to English bankers,† and is thrown out merely as a suggestion, I do not see that it is open to objection.

It would probably be wiser not to add the reserves of the existing Banks to the capital and distribute them by way of a new issue of shares. Although this would mean, in effect, no more than a change in bookkeeping, it is open to the objection that it would weaken, in appearance, the balance-sheet of the new Bank and create an unwieldy nominal capital on which to pay dividends.

It may be objected that the proposed scheme takes no account of the fact that the market values of the shares of the three Banks are not all at quite the same level.‡ It is not likely, however, that, when the assets have been revalued, the actual earning power of the Banks in recent years ascertained, and the necessary readjustments made by payment of cash bonuses or otherwise, so as to bring the ratio of surplus assets to capital to the same proportion for each Bank, that any appreciable difference between the position of the three Banks will be apparent. If on investigation it were to appear that the real earning powers of the Banks or the ratios of surplus assets to capital are substantially different, it would be proper to make allowance for this. But everything points to the reasonableness of taking a broad view and treating all the Banks on a uniform plan.

The question of the division of profits between the shareholders and the Government raises a problem of a good deal of difficulty. Apart from the question of prestige, the management of the note issue and of the Government balances will provide the Bank with a considerable source of revenue, likely to grow in the future, in the fruits of which the Government must obviously share.

One method would be for the Bank to pay for the prestige by performing certain Government services without remuneration, and for the use of the public balances by a sum dependent on their amount and the bank rate; and for the Government to retain the estimated profits of note issue. This method would not be satisfactory. There is no certainty that the arrangement would work out equitably as between the shareholders and the Government. And the chief objection to it is in the inherent difficulty of separating the business of the Bank into compartments, and of deciding

* The existing shares of the Presidency shares stand at a premium of more than 200 per cent.

† Nevertheless the "A" shares, created this year by Barclay's Bank, are not very different from preference shares.

‡ Market quotations, August 1913 :—Bank of Bengal, Rs. 1,700 ; Bank of Bombay, Rs. 1,670 ; Bank of Madras, Rs. 1,440. In each case the quotation is for Rs. 500 shares.

how much of its net profit it has derived from each source. Such a method of division of profits runs counter to what ought to be an important principle of a central Bank—the regarding of the Bank's operations *as a whole*.

In the case of the Bank of France, the Government receives no direct share of the profits of the Bank, but gets its benefit in a rather complicated way by a number of indirect services and payments. But the normal continental arrangement is one in which the Government receives its advantage partly by the free performance of services on the part of the Bank, partly by a tax on the note issue, and partly by a share in the profits. The arrangements which govern the distribution of the profits of the Reichsbank are given, as the leading example, in Appendix C. The details of the German plan are not suited to the Indian conditions; but the general idea running through it is, I think, a good one.

In the case of the Imperial Bank of India, I suggest something of the following kind :—

1. The Bank shall perform without special remuneration the following duties :—

(*a*) To purchase gold bullion at a notified rate, to issue (but not mint) gold and silver, to manage the note issue and the custody of the Paper Currency Reserve.

(*b*) To accept payments and make disbursements on behalf of the Government (Imperial and Local) at all places where the Bank has set up a branch.

(*c*) To manage the Government debt in India.

2. The Bank shall pay to the Government annually a sum equal to the present income from the *sterling** investments now in the Paper Currency Reserve, and from such investments as may be transferred from the Gold Standard Reserve in exchange for gold (*see* below). The Bank shall also pay over the proceeds of any tax chargeable on excess issues of paper currency (*see* Regulation of Note Issue, below).

3. The annual net profit of the Bank, after due allowance for depreciation, preference dividend (if any), &c., and after deducting payments to the Government under (2) above, shall be dealt with in the following manner :—

(*a*) A regular dividend of 10 per cent. on the ordinary capital to be distributed among the shareholders, being made up to this amount from the reserve, if the net profits fall short of 10 per cent.

(*b*) Of the remainder, after payment of 10 per cent., two-fifths to be transferred to the reserve when this remainder is not more than 20 per cent. of the capital, and one-third when it exceeds 20 per cent.

(*c*) The divisible surplus, after deductions (*a*) and (*b*) shall accrue to the shareholders up to an additional 5 per cent. of their capital, and thereafter to the shareholders in the proportion one-third, and to the Government in the proportion two-thirds.†

The effect of these provisions is shown in the following table :—

In Percentages of the Capital.

Net Profits, Percentage.	Percentage to Shareholders.	Percentage to Reserve.	Percentage to Government.
8	10	— 2	—
10	10	—	—
12	$11\frac{1}{5}$	$\frac{4}{5}$	—
15	13	2	—
16	$13\frac{3}{5}$	$2\frac{2}{5}$	—
18	$14\frac{4}{5}$	$3\frac{1}{5}$	—
20	$15\frac{1}{3}$	4	$\frac{2}{3}$
22	$15\frac{11}{15}$	$4\frac{4}{5}$	$1\frac{7}{15}$
25	$16\frac{1}{3}$	6	2
28	$16\frac{14}{15}$	$7\frac{1}{5}$	$3\frac{13}{15}$
30	$17\frac{1}{3}$	8	$4\frac{2}{3}$

* For the treatment of the *rupee* investments now in the Paper Currency Reserve, *see* below.

† Provision should probably be made for an increased proportion to Government and diminished proportions to the shareholders and to reserve, in the event of the net profits ever exceeding 30 per cent.

At present the net profits are approximately 17 per cent., of which 14 per cent. is divided and 3 per cent. placed to reserve. Under the above scheme the Government receives no share until 15 per cent. is being divided amongst the shareholders and nearly 4 per cent. placed to reserve. Thus, the position of the shareholders is almost certainly improved, and the Government take no appreciable part of the profits unless the control of the paper currency, the custody of the Government balances, and the prestige attaching to a State Bank have the effect of raising the profits very greatly above their present level. Those who believe that the establishment of a State Bank may have a very beneficial effect on Indian commerce and banking, will think it wise to facilitate such a course by a fairly generous offer to the existing shareholders.

One or two points may be added.

There has been a wise provision in the successive arrangements between the State and the Bank of France, by which the Bank is bound to open a certain number of additional branches within a given period of years. This undertaking is reckoned, as it were, as part of the payment made by the Bank for its privileges. In the case of the Bank of India, I suggest that while the Presidency Boards shall have discretion to open branches wherever they wish, they shall also be required to open them at the request of the Central Board, and that it shall be the declared policy of the Central Board to open branches, as rapidly as opportunity offers, and the necessary staff and organisation become available, at most places where there is now a District Treasury.*

There must also be conditions, as in the constitution of the Reichsbank, providing for the revision of relations between the shareholders and the Government.

1. The Bank Act shall be reviewed at intervals of 10 years, and shall be subject to equitable revision at the option of Government or at shorter intervals with the concurrence of the shareholders.

2. At each decennial revision the Government shall be free to take over the whole goodwill and assets (including the reserve) of the Bank at 25 years' purchase of the average of the sums payable to the shareholders in the five years preceding.

The first provision may seem to place the shareholders somewhat at the mercy of the future good faith of the Government. But it is difficult to limit the authority of a sovereign power. Every institution, however purely private, is ultimately dependent on the Government's equitable regard for existing interests. From a Government which was deliberately prepared to revise the charter *inequitably*, even a Presidency Bank would hardly be safe.

The profits of an Indian Bank are likely to be very fluctuating. It might be advantageous, therefore, if the shareholders were competent to form a reserve for the equalisation of dividends, which should remain wholly their own property in all circumstances. This might be invested in Government paper, or held by the Bank on payment of interest at a rate equal to the average bank rate during the year.

V.

REGULATION OF THE NOTE ISSUE.

The chief object of the principles set up in 1844 to govern the Bank of England's note issue was the certain avoidance of those evils attendant on an inconvertible and inflated paper currency, of which the history of the previous half century had contained notorious instances. In attaining this object by too rigorous a set of rules the utility of the note issue was destroyed. The main function of the Bank of England's notes at the present time, apart from a very few special types of transaction, is to supply the Joint Stock Banks with a convenient form of bullion certificate more easily handled than bullion itself. The inconveniences which would otherwise have arisen have been avoided, however, by the great development of the cheque system.

* These are 271 in number, while the Presidency Banks have at present only 35 branches between them. It will naturally take some time, therefore, to complete this policy of expansion.

Abroad the Bank of England's principles have found no imitators. But in India they were adopted in 1860 and still persist. The effect of their rigour is not moderated by any widespread use of cheques. Many authorities are now agreed that some development of elasticity in the note issue is, therefore, required.

When we look to the experience of other countries, of which much has now accumulated, as to how this elasticity can be best obtained, the following alternatives are before us:—

(i) A fiduciary issue fixed in *amount*, as in the case of the Bank of England, but with power to exceed it (until the cash falls to a certain minimum *proportion*) on payment of a tax. This is the system in Germany and elsewhere.

(ii) A fiduciary issue fixed in *proportion* to the note issue.

(iii) As in (ii), but with power to exceed the proportion on payment of a tax.

(iv) No rules but the discretion of the bank of issue to govern the amount of the reserve, but a limitation to the aggregate issue of notes. This is the system in France, where the maximum placed on the aggregate issue has been raised from time to time whenever the actual issue showed signs of approaching it.

In the choice of a system for India, the fourth of these alternatives can be put on one side. The second ought to be neglected also. For on this system, when once the prescribed proportion has been reached, not a single additional note can be encashed without a breach of the Bank Act; for if one note is cashed, the fiduciary issue, being the same as before while the cash is less, must exceed the prescribed proportion.

Our choice lies, therefore, between (i) and (iii). Between these two there is not really any very substantial difference. For when the *amount* is fixed from time to time, it is naturally fixed so as to be some reasonable *proportion* of the total. In the case of a country with a rapidly growing note issue, the advantage lies, I think, with (iii); otherwise frequent legislative changes will be required. Germany adopted (i) in the first instance, because it seemed less of a break with the Bank of England's system; but, as their note issue has developed, frequent legislative changes have been necessary to raise the amount of the untaxed fiduciary total, so as to make it a reasonable proportion of the whole circulation.

In what follows, therefore, I propose for India a variety of (iii):—

Proposed Rules to govern the Indian Note Issue.

1. Up to 40 per cent. of the gross* circulation of notes may be held in a fiduciary† form without payment of tax, the balance being held in cash (gold or rupees).

2. Up to 60 per cent. may be held in a fiduciary form, on payment of a tax to the Government at the rate of 5 per cent. per annum on the excess of the fiduciary issue above 40 per cent of the total circulation.

3. The proportion, in a fiduciary form, shall *never* exceed 60 per cent., *i.e.*, the proportion of cash shall never fall below 40 per cent., save that the Secretary of State in Council shall have authority, in emergency, to suspend the provision of the Bank Act which enjoins this.

The propriety of the particular percentages here proposed is, of course, a separate question from the propriety of the principle. In judging of it, we must bear in mind that, while the percentage given in (i), *i.e.*, 40 per cent., is what one would expect the Bank to work up to not infrequently, the percentage given in (2), *i.e.*, 60 per cent., is an outside limit, which the Bank would never work near to except, possibly, on occasions of dangerous crisis. For if it ever worked near to 60 per cent., the encashment of a few notes would put it in danger of having to apply for a suspension of the Bank Act. Thus, if the absolute maximum is fixed in the form of a *proportion*, plenty of margin must be allowed, and the maximum proportion must be fixed well above what would be thought the highest reasonable proportion for normal

* This is interpreted below to include the notes held by the Bank itself in reserve, as well as the "active" circulation.

† *What* fiduciary form, is discussed below.

times. If comparisons are to be made, this figure is considerably more cautious than the corresponding figure for the Reichsbank. The legal maximum proportion for their fiduciary issue is 67 per cent., but as the so-called "cash" includes some items which are not cash at all, the corresponding figure may be put at 70 per cent. In September 1911 the Reichsbank actually worked up to 57 per cent., holding only 43 per cent. in cash at the end of that month. In September 1912 they worked up to 50 per cent. This year the authorities have felt that to work up to such a figure in comparatively normal circumstance may be incautious, and they have somewhat strengthened their position. But no one has suggested that they should lower the proportion up to which they are *legally entitled* to work. I am clear, therefore, that it would be unwise, in the case of India, to fix the legal maximum below 60 per cent. (*i.e.*, to fix the legal minimum of cash above 40 per cent.). Plenty of "play" ought to be allowed for occasions of emergency, when even a suggestion of a suspension of the Bank Act might provoke panic. But it is equally clear that the *normal* maximum ought to be well below this amount. For this, reliance must inevitably be placed on the judgment of those in authority at the Bank, and not on legal safeguards.

The propriety of the figure, namely, 40 per cent. fixed in (1) is much more open to question. It partly depends on how much tax is to be paid on excess issues. I believe that it would be safe to allow the Bank to work up to this amount before any pressure need be put on the authorities, other than their own judgment, to raise the bank rate. But no principle is involved in the choice of this particular figure.

The existing fiduciary issue was 24 per cent. of the *average* gross and 26 per cent. of the *minimum* gross circulation in 1911–12; and the corresponding figures (estimated) in 1912-13 were 21 per cent. and 24 per cent. Precise comparison with the Reichsbank is not possible, because at any given date their fiduciary issue is a fixed amount and not a fixed proportion; but a study of the figures suggests that 40 per cent. is about the equivalent of German practice.

We may take the present normal minimum gross circulation at about 60 crores of which from 42 to 45 crores is active (*i.e.*, excluding Government Treasuries and Presidency Banks); of this 14 crores is now held invested. The notes now held in Government Treasuries, as well as those now held in the Presidency Banks, would be held in the reserve of the new Bank, although, presumably, the former would not be maintained at their present magnitude. We may assume that the Bank, like the Bank of England, would hold its whole cash reserve, apart from till money, in notes (*see* below).

Now, if in the slack season there were 40 crores in circulation and 20 crores in the Bank's own reserve, the fiduciary portion could rise without payment of any tax to 24 crores.

If in the busy season the active circulation rose to 45 crores and the reserve fell to 15 crores, the fiduciary portion could rise, as before, to 24 crores without payment of tax, and 4 crores higher on payment of a 5 per cent. tax on the excess 4 crores, a safe margin being still preserved below the permissible maximum of 36 crores. Recent experience shows that the circulation would frequently rise higher than this.

This scheme would, therefore, put very large funds at the disposal of the Bank. Nor would any risk be run of inability to encash the notes, as is shown in the following table, which gives the percentage of cash to active circulation in each of the hypothetical cases instanced above and in some others also :—

In Crores of Rupees.

Active Circulation.	Notes in Reserve.	Fiduciary Issue.	Cash.	Percentage of Cash to Active Circulation.
40	20	24	36	90
45	15	24	36	80
45	15	28	32	71
50	20	28	42	84
50	20	30	40	80

Further, probably 10 to 15 crores of the reserve held against the fiduciary issue (*see* below), would be held in sterling securities or sterling bills, capable of being realised in London. Thus more than 100 per cent. of the active circulation would be held either in cash or in sterling securities.

Finally the existence, quite apart from the Paper Currency Reserve, of a large sum in gold coin (if proposals to this effect are adopted) in the Gold Standard Reserve must be borne in mind when the possibility of grave emergencies is in question. In all ordinary times the existence of the Gold Standard Reserve should be treated as irrelevant to the proper magnitude of the Paper Currency Reserve; but against very grave emergencies, when the Government's guarantee of the note issue (*see* below) may possibly be required, the coin in the Gold Standard Reserve would provide a temporary bulwark, pending the realisation of the sterling securities.

It would hardly be reasonable, I think, to criticise the above scheme on the ground of insecurity to the holders of notes.* These figures also bring out the essential wastefulness of the present system. More than 100 per cent. of the *active* circulation is now held in cash.

So far merely the amount of the fiduciary issue has been discussed, and not the form of the securities to be held against it. At present 10 crores are held in rupee paper and 4 crores in Consols. It is suggested below that 6 crores in Consols should be transferred, in exchange for sovereigns, from the Gold Standard Reserve. This would make 20 crores in all of permanent investment, and this is certainly the highest figure at which the permanent investment ought to stand at present; perhaps it is too high.

The security for the fiduciary issue, beyond the 20 crores of permanent investment, should consist of approved securities (Government paper and possibly a few others) temporarily transferred from those held by the Bank on its own account or pledged with it by its customers, and of bills of exchange, both sterling and rupee. The securities, pledged with the reserve, should be taken at a safe margin below their market value.

For the fluctuating part of the fiduciary reserve, bills of exchange having two good names to them are far preferable to securities, if they can be obtained. They come into existence precisely at the moment when there is most need for additional currency and are liquidated when this need comes to an end. Securities, on the other hand, must be carried by somebody all the year round. Moreover the amount of securities forthcoming is likely to be limited. Suppose a Bank or a firm can get money at 5 per cent. on the security of Government paper and use it at 6 per cent. for three months in the year, then on the average of the year they make about $4 + \frac{1}{4}(6 - 5)$ per cent., *i.e.*, $4\frac{1}{4}$ per cent. It suits a Bank to hold some Government paper. But the above calculation show that a point would soon come when this would not pay. Bills, on the other hand, do not lock up money all the year round. To discount at 6 per cent. and rediscount at 5 is a much more profitable transaction for a Bank than the transaction outlined above.

Experience elsewhere shows that the elasticity of notes based on Government paper is very limited, and that bills are the essentially suitable backing to that part of the note issue which is fluctuating and called into existence in the busy season only. The amount of Government paper which it suits the banks to hold, since it must be held all the year round, is not suddenly expansible; nor is it easy for them suddenly to liquidate their holdings, or, from the Government's point of view, desirable that they should. The American note issue, which is based on Government paper, has proved hopelessly inelastic, and it is one of the principal objects of the projected reforms in that country to introduce an elasticity based on the

* The normal proportion of cash to active circulation would be higher than in most European systems of note issue, higher even than in the case of the Bank of France.

discount of trade bills.* In all European countries bills are the pivot on which the whole meaning and utility of the note issue essentially turns.

The only question is how far bills of a kind suitable to the portfolio of a State Bank would be forthcoming in India. It might be a matter of time before they would be available to the full extent which is desirable.

This leads us to the question of the relations of the State Bank to other banking institutions. The State Bank ought to aim, I think, to the greatest possible extent at *re-discount* business. So far as possible, that is to say, it should aim at filling its portfolio with trade bills which have passed through the hands of another Bank or shroff or marwari of high standing and have received their endorsements. This seems to me to be the right channel through which the accommodation newly available should filter down to the great mass of Indian traders. The State Bank would have on its list certain Banks and private native financiers of high standing who would be amongst its regular customers and for whom in general it would be prepared to rediscount freely.

The power of re-discount might prove a powerful aid to the development of Indian Joint Stock Banks on sounder lines than hitherto, and involve at the same time a valuable check on them. For, on admitting a Bank to the re-discount list, the local manager of the Presidency branch would require, from time to time, to examine somewhat carefully, in confidence, the Bank's position; and the risk of losing its position on the re-discount list might act, to some extent, as a deterrent to rash banking.

Apart from this check, the creation of a re-discount market would render such Banks most vital assistance. Indeed I am doubtful how far it is possible for them to develop on really sound lines without it. The smaller the Bank, the larger the number of its branches, and the less developed in banking habits the country in which it acts, the higher in proportion to its resources ought its free cash reserves to be. If a newly founded Indian Joint Stock Bank were to keep sufficiently large cash reserves to provide against all reasonable contingencies, it could scarcely hope to earn adequate dividends. At present, apart from cash, such a bank is very short of modes of so employing its resources as to keep them fairly liquid. There is no one to whom they can safely lend at call. A Bank which pays from 4 to 6 per cent. to its depositors cannot be expected to hold large quantities of high-class investments yielding barely 4 per cent. Such bills as they may get hold of must probably be held until maturity. Inevitably they tend to lock up in industrial enterprise a higher proportion of their resources than is wise Some recent failures seem to be due to a different cause, not so much to the locking up resources as to advances against *worthless* security. But in really bad times comparatively well conducted institutions may find themselves in difficulty, not because their security is worthless, but because it is temporarily unrealisable.

If a State Bank were to encourage the transaction of business by means of trade bills, through making bills easy things against which to obtain advances, native Banks might hope in time to obtain more of them for their portfolios and would have something which they could turn into cash at need by re-discount.

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* The following quotation from a recent communication to *The Standard* about the less well-known experience of Cape Colony is instructive :—"The Cape legal tender issue represents "the only attempt to establish a scientific system in South Africa, but it becomes increasingly "clear that this system is not suited to satisfy the larger requirements of the Union. The "application of this system to the Union would necessitate, on the part of the banks of issue, "the investment of additional funds in Government securities as cover, which fact, in its "turn, would narrow the already small margin between deposits and advances, and thus "lessen the Bank's power to grant facilities. This system has already proved inelastic, "despite its limited range, a fact in itself proving its unsuitability for adoption as the note "currency of the Union. Despite the demand for currency by trade during the last few "years, the Cape circulation has rarely exceeded 1,200,000*l*., although as long ago as 1891 "experts placed its natural level at 2,000,000*l*. . . . . In short, the Banks are finding "more profitable means of investment for their funds than Government securities, and the "Cape note circulation consequently does not expand."

In this matter of the development of the use of trade bills, however, I am looking not so much to the immediate future as to the ultimate development of Indian banking practice on sound and well-tried principles.

Two further points in regard to the note issue remain for discussion.

The notes must, I think, remain Government notes in the sense that the Government, in addition to the Bank, guarantees them. In this case they could preserve their present form and appearance unchanged, *i.e.*, they could remain, as they are at present, Government promissory notes payable on demand at certain places in legal tender money.*

This should allay suspicion without laying on the Government any real additional burden. For if the Bank were, by a violent chance, to get into difficulties, there cannot be the least doubt that the Government would have to maintain the solvency of the note issue whether they had formally promised to do so or not.

The remote contingency of the Government's having to give temporary effect to this guarantee could be properly laid on the Gold Standard Reserve. For, although an exchange crisis changes the form of the Gold Standard Reserve, it in no way affects the total amount of legal tender money held there.

The Government's guarantee carries with it as a necessary consequence —probably desirable on general grounds anyhow—the allocation of specific assets as cover for the note issue and a division in the Bank's published accounts between the Issue and Banking Departments. Rather oddly, this feature of the Bank of England's arrangements has not been generally imitated abroad. In the normal continental type, no distinction is made between the reserve held against the note issue and the reserve held against other banking liabilities. Legally, the whole cash reserve is treated as being cover for the notes; and no notes are held by the Bank itself, so that there is no distinction between total and active circulation. Among its assets the Bank must hold a sufficient quantity of security of a kind which is legal backing for the fiduciary part of the circulation; but no part of the Bank's securities is specifically allocated to the note issue.

In this respect the Bank of England provides India with the better model. In the published accounts a distinction should be made between the Issue and the Banking Departments thus (with hypothetical figures)† :—

Issue Department.

	Crores.		Crores.
Gross circulation of notes outstanding - - - -	65	Government Book Debt - -	10
		Consols - - - - - -	10
		Security pledged with Issue Department:—	
		Approved securities - } Bills of exchange - - }	6
		Gold - - - - - -	15
		Rupees - - - - -	24
			65

* In 1900 the Government of India in a despatch (18th Jan. 1900) to the Secretary of State regarding proposals for the transfer of the note issue to a central Bank, wrote :—"As " any change in the form of the note might involve temporary contraction in the paper " circulation, as change in such matters is peculiarly undesirable in India, and as the reserve " would be under the supervision and control of Government, we should have no objection " to the notes continuing in their present form, with the possible addition of the name of " the Bank and the counter signature of the officer employed to supervise the reserve. We " are of opinion, though not forgetting the objections that have been previously raised to " such a course in India, and indeed recently adverted upon by so high an authority as " Lord Northbrook, that there is nothing in the peculiar circumstances of India to prevent " the note issue being transferred to a Bank. We are, moreover, disposed to believe that " it is through the agency of a Bank that the note issue may have a larger development in " India."

† In a continental Bank these two accounts would be merged, the circulation of notes would appear as 45; no notes would appear on the asset side of the banking account; and the investments and bills in the two departments would be lumped together. This would make the proportion of cash to circulation appear to be 87 per cent., instead of 60 per cent. as in the above. This difference in account-keeping, which makes the position in continental Banks appear stronger than it really is, must be kept in mind in making comparisons.

Banking Department.

Capital, &c.	Notes in Reserve - - -	20
Deposits, &c.	Investments	
	Bills	
	Advances, &c.	

Several details in this require explanation :—

1. The "Government Book Debt" corresponds to the 10 crores of Government rupee paper now held in the Paper Currency Reserve. I propose that this rupee paper should be cancelled, and be replaced by a Government book debt bearing no interest. This corresponds to the Government book debt due to the Bank of England, and avoids fluctuations in accordance with the market value of rupee paper.

2. The Consols (four crores from the existing Paper Currency Reserve and six crores from the Gold Standard Reserve in exchange for gold) would be taken over at market value. The initial book value should, in the event of subsequent depreciation, be written down to market value annually, but should not be written up, in the event of appreciation, until market value exceeds book value by 10 per cent., and then only by the excess beyond 10 per cent.

3. The approved securities, pledged with the Issue Department should show a margin of 5 per cent.; the bills of exchange should be taken at par, less rebate.

4. So long as the fiduciary issue does not exceed the untaxed maximum, it will make no difference to the Bank's profits whether they make up the gross circulation to the untaxed maximum by transfer of securities to the Issue Department and increase the notes in reserve correspondingly, or let the gross circulation fall below the untaxed maximum by a reduction of the notes in reserve. When the untaxed maximum is passed it will pay the Bank better to let the notes in reserve fall somewhat, as they will avoid payment of tax by the amount of the fall. This circumstance is, no doubt, the explanation of the continental method of account-keeping. But, provided the Bank is governed by caution, the extent to which they will feel willing to reduce their notes in reserve in order to avoid payment of tax will be no more than is reasonable. And even if the notes in reserve sank to zero, the position, measured by percentage of cash to note issue, would still be as strong as in a continental Bank.

5. As the Government guarantees the note issue, the securities and cash belonging or pledged to the Issue Department will become their property, so far as required for meeting liability on the notes, in the event of difficulties. But apart from the interest on the 10 crores of Consols, the annual profits of the note issue (and any excess in the value of the assets of the Issue Department over its liabilities) are the property of the Bank.

In concluding this section, a word may be said about the Circle System. There seems no reason why it should not be abolished. There should be a legal right of encashment of notes of all denominations at a small number of prescribed offices of the Bank; and all other offices, though under no legal obligation, should be authorised to encash notes whenever they can do so without embarrassment. It is to be hoped that, as time goes on, the occasions when they would not find it convenient to encash them would become increasingly rare. The notes are, of course, legal tender, and must be accepted *in payment* by all branches of the Bank.*

* *Cf.* § 18 of the German Bank Act :—

The Reichsbank is required to redeem its notes to bearer in German currency (N.B., in silver or gold at the option of the Bank) :—

(*a*) At the main office in Berlin, and

(*b*) at its branch offices *as far as the cash and money exigencies of the latter permit.*

VI.

THE LONDON OFFICE AND REMITTANCE.

With this section we enter on a debatable part of the subject, which is largely independent of the rest.

No important object would be served by allowing the Bank to compete with the Exchange Banks in attracting deposits in London. Nor is there any clear advantage (sufficient to counterbalance the opposition which would be aroused) in allowing it to enter into the regular business of trade remittance by buying trade bills in both directions. Such competition with the Exchange Banks is in no way necessary to the prime objects of a State Bank.

But it is desirable that the Bank should be free to carry out the Secretary of State's remittance in the most satisfactory and economical way, and to hold balances in London and use them in the London market. It is also desirable that the Bank should not be unduly fettered in providing private remittance on London for its Indian customers. If at some up-country branch of the State Bank a customer wished to buy a draft on London for 50*l*., it would be absurd if the Bank had to refuse to do this business for him.

The London Office of the State Bank would be, therefore, a comparatively small affair. It would have no direct dealings with the public, only with the Secretary of State, the Money Market, and other Banks. The Secretary of State would continue to do his ordinary banking business with the Bank of England and to maintain a balance there; and it would be the business of the London Office of the State Bank to keep him in funds. The main point for discussion is as to what the best machinery will be for carrying out the remittance transactions wherewith to keep the Secretary of State in funds.

The methods of effecting remittance are two: by selling drafts on India in London, as at present, and by buying sterling bills in India. There will be great advantages in leaving both these methods open to the Bank. The due safeguarding of the interests of existing Banks is not incompatible with this. The State Bank should be precluded from buying sterling bills in India, *except from other Banks;* its dealing in sterling bills, that is to say, should be entirely a re-discount business of bills bearing the endorsement of another Bank. The sale of rupee drafts in London might be by tender as at present, but it would probably be a better plan for the London office of the State Bank to quote rates for bills and transfers to applicants. In this matter, also, the State Bank should be confined to dealing with other Banks and not direct with the trading public, or (as an alternative, if this proposal should be deemed a hardship to certain important houses which tender direct for Council bills at present and do not, as it is, do their business through an Exchange Bank) should sell for not less than a lakh at a time.*

The Exchange Banks would thus have two ways of putting themselves in funds in India, corresponding to the two ways open to the State Bank of providing themselves with funds in London. They could re-discount sterling bills in India or buy (as at present) rupee drafts in London. The existence of the first method, as well as the second, might sometimes prove a real advantage to them. The State Bank would naturally quote rates for re-discount in India and for the sale of drafts in London which would make it worth the while of the Exchange Banks to take the course most convenient at the moment to the State Bank. If at a season when the Exchange Banks were wanting funds in India, the Secretary of State was also in need of additional cash in London, inducement would be offered to the Exchange Banks to buy drafts; and if the Secretary of

* At present, however, "specials" are often sold by the Council for much less sums than this.

State's needs were mainly in the future, inducement would be offered to the Exchange Banks to re-discount sterling bills in India, which could be held by the State Bank until the Secretary of State wanted the money.

The price which would be paid for sterling bills in India by the State Bank would necessarily be governed by the London rate of discount for such bills taken in conjunction with the rate of exchange, not by the local rate for rupee bills. Thus, if the London rate of discount for three months' sterling bills of this type were $4\frac{1}{2}$ per cent. and exchange stood at $1s.\ 4\frac{1}{16}d.$, the corresponding rupee price for three months' sterling bills offered in India would be approximately $1s.\ 4\frac{1}{4}d.$ per rupee. Any concession on this price offered by the State Bank in India, so long as its London office was able to enforce $1s.\ 4\frac{1}{16}d.$ as the rate for telegraphic transfers on India, would be an inducement to the Exchange Banks to re-discount in India rather than re-discount in London and then buy telegraphic transfers there. At the same time, such a policy might be advantageous to the State Bank itself. As the London rate of discount is frequently below the Indian rate, this policy would sometimes involve re-discounting sterling bills at what would be, in effect, a lower rate than was being allowed on rupee bills. But this could afford no reasonable ground of complaint to Indian merchants. For the money thus employed would not have been available in any case for rupee advances. The alternative to the use of these funds for the re-discount of sterling bills would be the remittance of them to London through the encashment of telegraphic transfers and their employment on the London market.

There can be no question that the method outlined above is the most perfect method of effecting remittance from the purely financial point of view, and also that it will be more easy of favourable explanation to the public, for the following reasons. At present the train of events is a very complicated one. The Exchange Banks buy sterling bills in India, which they bring to London and re-discount, in part, in the London Money Market. With the proceeds of re-discounting they buy Council drafts or transfers from the Secretary of State, which, when encashed in India, replace the funds which the Banks have paid out in originally buying the sterling bills. The Secretary of State lends the proceeds of selling Councils, until such time as he has need of them for his disbursements, either to the Exchange Banks themselves or to other constituents of the London Money Market, by whom the money is largely used for rediscounting bills either for the Indian Exchange Banks or for similar institutions working in other countries. If, on the other hand, as is proposed above, the State Bank were to re-discount sterling bills for the Exchange Banks in India and hold the bills until the money was actually wanted by the Secretary of State, the whole (or nearly the whole) of the floating sterling resources would be directly employed in the assistance of India's foreign trade, instead of assisting it in a very slight and indirect way through general help given to the London Money Market. No one could justly maintain that money was being diverted away to purposes wholly unconnected with India. In the second place the floating sterling resources would earn a higher rate of interest than at present, partly through the elimination of an intermediate profit and risk, and partly because three-month bills could safely be taken in many cases in which money is now lent by the broker for only six weeks.* And, in the third place, these advantages would not be counterbalanced by any increase of risk. Whenever it turned out that the Secretary of State was in need of funds somewhat sooner than had been anticipated, it would always be possible to re-discount at the Bank of England on favourable terms sterling bills, domiciled in London, and bearing the endorsements both of the State Bank of India and an Exchange Bank. Apart from the ease of rediscount, such bills would afford the finest possible security, and the Bank could only suffer loss in the event of the simultaneous

* Because, if it turned out that the money was wanted after six weeks, the bills could be re-discounted at the Bank of England. At present money is not lent for more than six weeks and seldom for so long, because of the remote contingency, which always exists, that it might be wanted by then. In giving evidence, the Secretary of State's broker seemed to be unaware that the *average* rate for three months' money is higher than the *average* rate for six weeks' money (*i.e.*, that a man who always lent for three months would make more on the average than a man who always lent for six weeks); but this is a well-known fact, or, if not well known, easily ascertained by reference to the records of recent years.

insolvency of the Indian drawer, the London acceptor, and the Exchange Bank through which the Bill had been negotiated.*

This proposal is in no sense novel, and is merely an adaptation to Indian conditions of the practice most usually followed by foreign countries. A foreign Bank or Government, which wishes to keep floating resources in a sterling form, generally utilises for the purpose so far as it can its portfolio of sterling bills negotiated in its own country.

The Exchange Banks might be further guaranteed against ordinary trade competition by restricting the State Bank in its London rediscount business to the Bank of England.

The above proposals together with a few further points of detail can be summarised as follows:—

1. The Indian offices of the State Bank shall be permitted to supply their own customers with sterling remittance, but in the purchase of sterling *trade* bills they shall be confined to the re-discount of such bills for other Banks.

2. The London office of the State Bank shall have no direct dealings as a banker with the general public. Its business shall be confined to:—

(*a*) The sale to other Banks† of drafts and telegraphic transfers payable at its Indian offices.

(*b*) The rediscount of sterling bills at the Bank of England.

(*c*) Borrowing for short periods from the Bank of England.

(*d*) The loan of funds on the London Money Market.

(*e*) The replenishment of the Secretary of State's funds at the Bank of England.

(*f*) The flotation of sterling loans on behalf of the Secretary of State.

To these functions another might possibly be added, namely, the management of the Secretary of State's sterling and rupee debt in London. But there are considerable advantages in leaving this with the Bank of England provided the charges made by them are not deemed excessive.

It remains to discuss the management of the London office.

There is some slight danger that through its close connection with the Secretary of State and the weight of authority on its Board, this office might tend to become too influential and important. This is sufficiently guarded against perhaps by the close limitations of its functions. It will have authority, of course, in regard to purely London questions, such as the employment of balances in London and advice as to the issue of sterling loans, but the only Indian question in regard to which it will be in a position to give authoritative advice will be the purchase in India of sterling bills.

The London Board will to a certain extent take the place of the present Finance Committee of the Secretary of State's Council, and may be expected to be in much closer touch with the India Office than is likely or desirable as between the Central Board and the Government of India. Its creation will fit in very well with Lord Crewe's recent proposals for a reorganisation of his Council, on which it will not be easy in future, as I understand his scheme, to find room for more than one financier. Room can be found on the London Board for those other financial advisers, the addition of whom to the Finance Committee has been advocated by several witnesses.

The London Board, which would not include the manager of the London Office, might consist of the Financial Secretary at the India Office (or the Permanent Under-Secretary or Assistant Under-Secretary when either of these is possessed of financial experience), the Member of the Secretary of State's Council specially attached (under Lord Crewe's scheme) to the Financial Department, a representative of one of the larger mercantile houses concerned in the India trade, and two other members of financial or banking experience (one of whom perhaps might be, in general, primarily of Indian experience and the other of London experience).

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* The smallness of the risk involved is well illustrated by some figures which have been calculated for the Reichsbank. They estimate that since their foundation in 1875 their average loss on bills is well under one-3,000th part. Many of these bills are for small amounts, and without the extra guarantee of re-discount, both drawer and acceptor are in the same country and subject to similar contingencies, and the period in question is long enough to include several occasions of crisis. The average loss on re-discounted sterling bills could hardly amount to as much as one-10,000th part.

† *See also* the alternative proposal, above.

VII.

OTHER FUNCTIONS OF THE BANK.

Some of the functions already discussed, together with one or two others, may be summarised:—

(1) The Bank will perform the same functions that the Presidency Banks perform now, with relaxation, in some particulars, of the existing restrictions.

(2) It will hold as Government banker, without payment of interest, the balances now held in the Reserve Treasuries and in London, with the exception of an emergency reserve of 1,000,000*l*. which would be retained by Government in India (as proposed by Mr. Abrahams), and of that part of the London balances held directly in the name of the Secretary of State at the Bank of England. It will also hold the Government balances at all places where the Bank sets up a branch.

(3) It will manage the Note Issue on terms outlined above, and, with the exception of certain payments to Government, will enjoy its profits.

(4) It will manage the Government debt in India; and it would probably prove advantageous to entrust it with the issue of new rupee loans.

(5) Its functions in regard to remittance and the duties of the London office have been discussed above.

The following duties should *not* be entrusted to it:—

(1) The management of the Mint.

(2) The custody of the Gold Standard Reserve.

But when the Gold Standard Reserve is brought into play for the support of exchange, the Bank should act, under the Government's orders, as the Government's agent in the matter.

Something may be said in this connection about the position of the Gold Standard Reserve in the event of the establishment of a State Bank.

In the immediate past the stability of the rupee has been supported both by the Gold Standard Reserve and by the Paper Currency Reserve. This has been necessary because the former reserve has not been quite strong enough to bear the burden by itself. But as a permanent arrangement it ought not to be necessary; or, at any rate, the Paper Currency Reserve ought to be used for this purpose to only a limited degree. The ideal to be worked up to is a state of affairs in which the Gold Standard Reserve is held by the Secretary of State for the *main* purpose of supporting exchange and is adequate to this purpose, and in which the Paper Currency Reserve is held by the Bank and is controlled *mainly* with an eye to the internal affairs of India. The Gold Standard Reserve, in this case, should be governed by ultra-conservative methods, being held in gold to a far greater extent than at present; while the Paper Currency Reserve should be ruled by more commercial considerations, and a much smaller proportion than at present held in actual cash.

Although the custody of the Gold Standard Reserve and the ultimate responsibility for the maintenance of exchange must remain, in the most direct manner, with the Secretary of State, he should use the Bank as his agent in the actual sale in India of sterling drafts on London on the occasions in which the Gold Standard Reserve is brought into play for the purpose for which it exists.

The moment at which this reserve is brought into play ought not to depend, I think, upon anyone's discretion, but should be governed by rule. There should be a notification, that is to say, that the Government will at all times sell, through the Bank as its agent, sterling bills on London at 1*s*. $3\frac{29}{32}$*d*. When advantage is taken of this it will be the business of the Secretary of State to put the London office of the Bank into funds wherewith to encash the bills thus sold.

The Gold Standard Reserve, while primarily held for the support of exchange, should not be legally earmarked for this sole purpose. It can properly be regarded (*see* above) as constituting, under certain conditions, an ultimate safeguard and guarantee of the convertibility of the note issue.*

VIII.

GENERAL ADVANTAGES OF A STATE BANK.

The outline of the proposed Bank's functions and of its draft constitution is now complete. A number of the advantages which are claimed for it have been developed in passing. It will be useful to summarise these, and to dwell on certain other points, not less important, which do not so naturally arise when it is the Bank's constitution which is the matter in hand.

There are first of all the direct advantages to Government. These affect questions which have been the special business of the Commission. The chief of them may be enumerated:—

(i) The existing "Independent Treasury System," by which, whenever the Government balances are swollen, deliberately or not. large sums are taken off the Money Market, is done away with by the removal of the cause of this system, namely, the absence of a large public or semi-public institution with which large balances could be safely and properly deposited, together with the difficulty of employing Civil Servants in a policy of discretionary loans out of the balances.

(ii) The objections to holding large sums at loan for short periods in the London Money Market are avoided by the method of dealing with sterling resources proposed in Part VI.

(iii) A Bank, responsible for the management of the note issue, has greater opportunities than are open to Government for pushing the circulation of notes and for popularising them by an increase in the facilities available for convertibility.

(iv) The responsibility of Government officials for a variety of financial and semi-financial business is greatly reduced by handing over to a Bank all questions of balances, note issue, remittance, and loans on the London Market.

(v) The Government has at its command the services of officers of the highest position, trained in financial and banking business, instead of Civil Servants who, however full of adaptability and intelligence, have been selected and trained mainly for other purposes.

(vi) A buffer is placed between the Secretary of State and vexatious criticism on small details of financial business.

Next come the immediate advantages to the business world:—

(i) In addition to the partial release of Government balances through their deposit in a central institution, a considerable amount of funds is made available by the reform of the note issue.

(ii) The present wide fluctuations of the bank rate and its normal high level in the busy season may be somewhat moderated.

(iii) The increase of branches, which the union of Government and banking business should promote, would gradually bring sound banking facilities to many parts of India, where they are now almost entirely wanting, both directly and by supplying a basis, in reliance on which private and co-operative banking could be built up.

(iv) The introduction of re-discount facilities, while probably not of the first importance in the immediate future, might greatly aid the eventual development of Indian banking on the most desirable lines which European experience has so far evolved.

* The propriety of this might be brought out further by showing that in a future crisis the convertibility of the note issue and the support of exchange may not always prove to be entirely distinct problems.

At this point something may be said about the bank rate question, and the possibility of obtaining substantially the same results without the interposition of a State Bank.

India suffers not from a high *average* bank rate, but from a wide range of fluctuation and a high *maximum* bank rate. If the *average* bank rate were high, this would mean that the normal return to capital under conditions of least risk was high; and this could not possibly be cured by any monetary device. But a high temporary bank rate, due to the increased volume of cash temporarily required for moving the crops, ought to be capable of amelioration by introducing an elasticity into the credit currency. It is important, however, not to under-estimate the magnitude of the problem. Several witnesses have maintained that a loan of three crores made by the Government from its balances or from the Paper Currency Reserve would be a sufficient cure for high bank-rates. I am convinced that this is a serious misapprehension of the facts. What is true is that at any moment an unexpected and sudden loan of three crores by the Government would break the current bank rate. If borrowers and lenders had adjusted themselves to an expectation of 8 per cent. it would be reasonable to hold that a sudden offer by the Government of three crores would bring the rate down to 6 per cent. or less. But this is not the standpoint from which to consider proposals for permanent policy. What present sources of supply would fail and what new sources of demand would spring up, if there were a reasonable expectation beforehand of borrowing in the busy season at 6 per cent. ?* Three crores is a very small percentage of the present transactions; it is not $1\frac{1}{2}$ per cent. of the value of the exports; it is barely half of the normal *annual* addition to India's banking resources; and to expect great consequences from the loan of it is to take a short-sighted and superficial view of the causes which really determine the value of money. The proposals made above in regard to a fiduciary issue of notes would have a more substantial effect; but I think it would be optimistic to expect even from them a normal maximum of 6 per cent. Their eventual efficacy is largely bound up with the future development of the use of notes.

This leads us to compare proposals, contingent on the establishment of a State Bank, with proposals for the loan of Government funds to the existing Presidency Banks. If the loans contemplated are comparatively small, there need be no difficulty in lending them on the security of Government paper, and the problem of the terms on which they should be lent, while not quite easy of solution, ought not to prove insuperable. But small loans could not, of course, have large consequences. Though they would, *pro tanto*, be useful and employ funds which are now wastefully idle, to offer them as a cure of high bank rate or of the existing faults in the Indian financial system is to trifle with the problem. If, on the other hand, fairly *large* loans are contemplated, other objections rise to importance. It is uncertain (for reasons given in Section V.) whether Government paper would be forthcoming in large quantities as security for temporary loans, and even more uncertain whether it is desirable to encourage the holding of a large amount of Government paper in this way. The Government could only get their funds back as a lender, by spoiling their market as a borrower. Yet there are great difficulties in lending by a Government department against the really desirable security, namely trade bills. It would take them to a wholly unfamiliar region, and require them to exercise an unaccustomed discretion.

The most serious objection still remains. It would be a perilous policy for the Government to lend on a scale sufficient to influence the bank rate, and for it to remain nevertheless wholly without responsibility for the bank rate policy. The ultimate lender and the ultimate controller of the credit currency cannot safely remain aloof from the control of the bank rate. So long as the Government do not lend and there is virtually no credit currency,

* The rate for money is largely determined by the *fringe* of borrowers and lenders who are specially sensitive to any change of conditions. If, for example, the normal maximum rate for money in India was to fall, some up-country traders could afford to pay the cultivator a little more and might hold the goods a little longer, since they would not be forced by high rates for money to hurry the goods forward to a place where they could form a basis for sterling credit.

the Government can maintain this aloofness from banking. As I have said already, existing arrangements are deeply conditioned by the fact of this aloofness. But if the Government are to lend their balances and to introduce, under their own control and discretion, a proper elasticity into the credit currency, and if they are to do these these things on a sufficient scale to make any real difference, then they cannot ignore considerations of bank-rate policy. Such a scheme involves an exercise of judgment on the part of Government officials in high matters of banking policy, without these officials having access to any first-hand banking experience. The Government is driven, therefore, to call in the assistance of a State Bank to do these things for them and to be responsible at the same time for the bank rate.

These considerations were apprehended by the Government of India when they put forward proposals for a Central Bank in 1900. After mentioning the suggestion of a note issue on the German model, they add:—"Theoretically we admit that the system might be grafted upon "the present management of the paper currency by Government. But "a Bank would be able to measure the need and extent of accommodation "much better than a Government could hope to do, and we believe that "in all countries where it has been adopted, the agency of a Bank has "been chosen for working this system. Moreover, in India recourse in any "form to a currency reserve in the hands of Government would encourage "the tendency to look to and rely upon Government exclusively. From "this point of view there would be particular objections to applying the "system to the currency reserve while it remained under Government "control." The last point seems to be a very sound one. Whenever the bank rate was high, there would be a clamour that the Government were not lending all they might.

Proposals for direct loans to the Presidency Banks, on a very moderate scale, from the Government balances and the Paper Currency Reserve may serve to meet certain of the more superficial criticisms. The Government will have an answer to the charge that they keep their whole surplus in a barren form. Indeed, so far, the proposals are good; and for every reason they will commend themselves to the lovers of appearance. But as an attempt to solve the real problems of the Indian financial situation, I do not think they are to be regarded seriously. They are incapable of future development, since they depend for their justification on the trifling and innocuous character of their consequences. And they are right off the line of banking evolution. They do nothing towards extending to India the advantages of civilised experience.

Something has been said of the advantages of a State Bank to the Government and of its direct advantages to the commercial world. I will turn in conclusion to some wider and more general issues; but must treat them briefly.

I attach great importance to the increased stability which a State Bank would introduce into the Indian banking system. India is not well placed at present to meet a banking crisis. The Presidency Banks are already Banker's Banks to an important extent, but they are not strong enough to support the whole burden. In effect the Government keeps a part of the banking reserves, but there is no machinery for bringing its reserves into normal connection with banking. With no central reserve, no elasticity of credit currency, hardly a re-discount market, and hardly a bank rate policy, with the growth of small and daring banks, great increase of deposits and a community unhabituated to banking and ready at the least alarm to revert to hoarding, even where it had been seemingly abandoned, there are to be found most elements of weakness and few elements of strength.

A recent article by Mr. H. M. Ross in "Capital" (September 4th, 1913) brings out these points very plainly. This article contains much which deserves reference, but the following passage is, in the present connection, the most important:—

"India and the United States of America are now practically alone among "the great trading countries of the world in possessing no Central Bank. "In view of the American banking crisis of 1907 the relation is an "ominous one. The vast monetary resources of the United States, badly

"handled and selfishly hoarded when they should have been freely used "where most required through the medium of a great central institution, "were of no avail to avert wholesale bankruptcy and a general suspension "of payment by the Banks. In a similar crisis it would be the policy, nay, "it would be the duty of each Presidency Bank to conserve its resources for "the benefit of its particular area. In the general interests of the country "this should not be." Mr. Ross might have added that India and the United States are also alone in having no re-discount market, no elasticity in the note issue, no bank rate policy, and an "Independent Treasury System" in place of a Government banker. In America the 1907 crisis served to demonstrate that such a system is indefensible, and the country is now engaged in remedying these defects so far as is possible in the very difficult circumstances which arise out of the presence of innumerable small Banks, on the one hand, all with vested interests and a terror of anything which might conceivably diminish their profits, and of a public, deeply suspicious of all moneyed interests and of anything which might strengthen their power, on the other.* In India the obstacles are far less to the introduction of the recognised preventives for the diseases of the financial body.

I have already pointed out the importance of a strong central institution in relation to the development on sound lines of native Joint Stock Banks. The encouragement of re-discount should be an encouragement to these Banks to use their funds, as they ought, in the assistance of trade, instead of in speculation or in fixed enterprises.

The great increase of branches in country districts may lead to the State Bank's playing an important part in the development of co-operative banking amongst agriculturists. The local branches should always aim at being the Co-operative Bank's bank and at helping them by judicious loans.

This increase of branches will be much facilitated when a single institution is in control of banking, the Government's balances, and the currency chest in country districts. At present there is apt to be unprofitable discussion between Government and Presidency Banks about (*e.g.*) the interest payable on loans or the subsidy required to support a branch bank where there is now a District Treasury. It would pay Government to give any subsidy short of the expense of maintaining the Treasury. But they are naturally unwilling to hand over too much profit to private persons and yet are not in a good position to gauge how much this profit would be. So long also as the District Currency Chests are not handed over to the branch bank, some economies are open to the Government Treasury which are not open to the bank. A system of haggling between the Government and Presidency Banks as to the opening of branches, in which both parties have to be convinced that they are certainly making a good bargain, must be worse than one in which the interests of the two parties are joint instead of opposed and the only consideration is whether a branch is worth opening *on the whole*.

In conclusion it is worth while to recall the Government of India's latest pronouncement on the subject, when in June, 1901, they were "regretfully compelled" to "hold the scheme in abeyance":—"We desire at the same "time to record our deliberate opinion that it would be distinctly advisable, if "practicable, to establish a Central Bank in India, so as to relieve Government "of its present heavy responsibilities and to secure the advantages arising "from the control of the banking system of a country by a solid and "powerful Central Institution."

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* Since the above was written, a new Currency Law for the United States has been carried. It is interesting to notice that, while decentralisation is secured by the establishment of from 8 to 12 regional Banks, the cohesion and strength of the new system will depend on the central Federal Board to be established at Washington (not New York). This Federal Board seems from the available account to have some slight analogy with the Central Board for India proposed above. "The Federal Board will consist of the Secretary of the Treasury, the Comp-"troller of the Currency, and five members appointed by the President with the consent of the "Senate. Its powers are enormous. A vote of five of its members can require a regional "bank to discount the paper of other regional Banks. It can fix the rate of discount. It can "temporarily suspend the reserve requirements. It can honour or refuse requests for notes "from the regional banks and has other important supervisory functions." The Government will bank with the new regional banks, and a principal object of the new organisation is to encourage the practice of re-discount.

IX.

SOME ADVERSE CRITICISMS.

The chief criticisms of proposals for a State Bank which I remember to have heard are the following:—

(1) That there is no popular clamour for it.
(2) That it would increase the responsibilities of the Secretary of State and expose him to vexatious questions in Parliament.
(3) That India is too large and too various in local custom to be worked by a single Bank.
(4) That the local jealousies of Bombay and Calcutta are too strong.
(5) That the former Bank of Bombay suspended payment in 1866.
(6) That talent is not available in India to staff the Bank's directorate.
(7) That it would not be fair on the Exchange Banks.

It is not quite just to these criticisms to give so bare a catalogue of them. Some of them become more imposing when they are enlarged on. In regard to several it is possible for each individual to judge for himself how much weight ought to be given them. An admirable summary of the views expressed by witnesses can be gathered from pages 18, 19, and 20 of the Index to the evidence.

(2) (3) (4) and (6) are, in my own opinion, the more substantial. With (2) I have already dealt. The particular constitution proposed for the Bank is designed, in part, to mitigate the force of objections (3), (4) and (6). Of these (3) has, I think, very little force provided that reasonable autonomy is allowed to the local Boards. I pressed all the witnesses, who raised this objection, to particularise the difficulties, arising out of the size and variety of India, which they chiefly had in mind; but without success. With regard to (6) it must not be forgotten that at least as much talent will be available as at present.

The "vested interests" question is turning out much less serious than might have been expected. The Presidency Banks of Bengal, Bombay and Madras show no pronounced signs of hostility, and the authorities of the two latter have declared themselves, subject to certain conditions, definitely favourable. The present system is so wasteful that a change will provide a wide margin of profit for the shareholders of these Banks to participate in.

The Exchange Banks seem likely to oppose any substantial change in the present position. Their legitimate trading interests, however, are very fully safeguarded in the above proposals; and, as they will share in the advantage of increased stability in the Indian financial system, opposition will probably be mistaken even in their own interests. They will be but repeating the mistake which they made in 1892 in opposing the closure of the mints. It might have been expected that they would have welcomed a measure intended to introduce stability into their business, and which has in fact made the fortunes of all of them. But they held at that time that it was on the fluctuations of exchange and on the supposed bounty given to exports by a depreciating currency that they chiefly depended for their profits.

In 1900–1 the amount of consideration which should be paid to the exclusive claims of the Exchange Banks was the subject of some difference of opinion between the Government of India and the Secretary of State. The former wrote:—"We cannot see that the Exchange Banks make out a "strong claim for protection, and a suggestion which has been made that a "Central Bank should be bound to make any and all remittances through their "agency is out of the question." And, later, in answer to the Exchange Banks' protest against "State-aided Competition":—"We could have wished "that this contention of the Banks, which appears to us to be untenable, had "been supported by some clearer indication of the actual manner in which "the competition they deprecate may be expected to prove unfair and "injurious." This comment is equally applicable to the evidence given to ourselves by Mr. Toomey and Mr. Fraser. As arising out of this evidence, it may be pointed out that the Exchange Banks have absolutely unrestricted opportunities for purely Indian business, that this side of their activities has

very greatly increased, and that Mr. Toomey deliberately depreciated the importance to them of the business of attracting deposits in London for use in India, a part of their business on which they used greatly to pride themselves and which was at one time no small part of the ground on which they claimed special consideration.

The memory of the business world is short. Apart from vested interest, the main difficulty in the way of the above proposals is the great *vis inertiæ*, engendered by an experience of good times and only to be dispelled, perhaps, by a taste of trouble. Further, I do not believe that reasonable opposition to them will chiefly depend upon the kind of detailed criticisms enumerated above, or that their essential parts are open to specific attack. The real ground of objection is at the same time more vague and better founded. The proposed scheme is a large one, and all of its consequences cannot possibly be predicted with certainty. Such a scheme must naturally provoke a doubt as to whether it is worth while to embark for a *terra incognita* which may, for all one knows, contain something hazardous in it. But the land must not be thought more unknown than it really is. The above proposals contain nothing more than an adaptation to Indian conditions of methods which have been tried successfully in a great many places.

6th October 1913. J. M. KEYNES.

APPENDIX A.

THE RELATION OF STATE BANKS TO THEIR GOVERNMENTS.

The existing arrangements in various continental countries and in Japan are given below in outline. I describe the Reichsbank and the Bank of France in a certain amount of detail, and the rest very briefly indeed, because these two are the prototypes of several others, the constitutions of which contain few original ideas.

Reichsbank.

No part of the capital is owned by the State.*

The authorities of the Bank are:—

1. The *Bank-Kuratorium*, consisting of the Imperial Chancellor as Chairman and four members, one appointed by the Emperor and three by the Bundesrat. This is of the nature of a Board of Trustees and meets only four times a year to receive a general account of the Bank's operations.

2. The *Bank-Direktorium*, consisting at present of a President, Vice-President and six members, all appointed for life by the Emperor on the nomination of the Bundesrat. This Board (to quote the Bank Act) is "the managing and executive authority of "the Reichsbank . . . . . Its orders are to be sanctioned by a majority vote, and "subjected to the instructions and directions of the Imperial Chancellor."

The *Direktorium* is "endowed with special independent powers, even though these "can be checked by higher officials; it acts in its own name as the central managing body "of the Reichsbank, forms its resolutions on its own responsibility by majority vote, and "has the rights of a 'supreme imperial board.'"†

3. The Central Committee of Shareholders (*Zentralausschuss*) consisting of 15 members elected by the general meeting of shareholders. This committee must meet at least once a month. Reports must be presented to them, relating to most of the more important weekly items in the Bank's transactions, and containing a statement of the *Direktorium's* views as to general policy. The committee's powers are purely advisory.‡ But the Bank Act enumerates a number of questions in regard to which "the suggestions of the Central Committee should receive special consideration." Amongst these may be mentioned the filling up of vacancies in the *Direktorium;* the drawing up of the annual balance sheet; the maximum amount to be loaned by the Bank in advances against collateral; the discount rate and the loan interest rate, as well as changes in the principles and the terms on which credit is to be given. The interests of the shareholders are further safeguarded by the annual appointment by the Central Committee of three of their number as deputies having the right to attend with advisory powers all sittings of the *Direktorium* and to examine the books of the Bank.

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* When in 1876 the Bank of Prussia was converted into the Reichsbank, the Capital previously held by the Prussian Government was repaid.

† *See* the official history of the Reichsbank, 1876–1900.

‡ Except on one or two minor points, not deserving of reference here, in regard to which they can veto change.

The salaries and pensions of the members of the *Direktorium* are fixed annually in the Imperial Budget.

The ordinary officials of the Reichsbank "have the rights and duties of imperial functionaries," and are precluded from holding shares in the Bank.

The members of the Central Committee of Shareholders draw no stipend.

The rules governing the management of the Local Head Offices (*Reichsbank Hauptstelle*) also deserve notice. The Reichsbank now has 486 branches* (as compared with 569 of the Bank of France), of which 20 are Head Offices. Each of these offices is under the supervision of a local board of at least two members and of a Commissioner (*Bank-Kommissarius*) appointed by the Emperor. The executive authority is in the hands of two managing officials. There is also for each such office a district committee, appointed by the Imperial Chancellor from amongst the shareholders of the Bank resident in the city where the Local Head Office is located. The powers of the local committee are similar to those of the Central Committee, and they also have the right to appoint two or three deputies for purposes of closer supervision.

These Local Head Offices have a high degree of independence. They are empowered to carry on independently in the district assigned to them by the *Direktorium* all forms of transactions permitted by the Bank Act. The signatures of the two managing officials of a Local Head Office are legally binding on the Reichsbank.

Besides the 20 Head Offices, there are 77 offices which have nearly as much independence as the Head Offices. All the rest of the branches are sub-offices directly dependent on offices or Head Offices, and requiring approval for their transactions by the higher office. According to the strict rule "no bill may be purchased by them which has not been previously laid before the higher office." But this rule has gradually been mitigated so that the higher branch can name to the sub-office those persons and business houses from whom, without inquiry in each case, bills may be purchased within the fixed limits of credit, with the reservation, however, that sanction may subsequently be refused.† In other respects the powers of sub-offices have been gradually developed. The chief obstacles, according to the official history, which have retarded the free development of sub-offices, are especially relevant to Indian conditions. In the first place the keeping of large balances at the sub-offices, or alternatively the too frequent remittance of money backwards and forwards, would have been involved. Sub-offices have not been allowed, therefore, on their own authority to accept fixed deposits on the one hand or to make advances against collateral on the other. In the second place "at the creation of the Reichsbank most of the directors of sub-offices "were not officials trained in banking, but agents some of whom performed the duties "of the office only as incidental work and received for it no fixed salary, but only a "percentage of the profits." In the course of its development the Reichsbank has tried two different lines of advance, the grant of increased powers to sub-offices in places where the amount of business was important, and the transformation of such sub-offices into offices. On the whole the second line of advance seems to have been the more successful.

Bank of France.

No part of the capital is owned by the State.

The authorities of the Bank are :—

The Governor.

Two Deputy Governors.

A General Council (*Conseil Général*) of 15 *Régents* and 3 *Censeurs*.

The Governor and Deputy Governors have always (since 1806) been appointed and removable at will by the Minister of Finance. The *Régents* and *Censeurs* are appointed by the 200 amongst the shareholders who hold the largest number of shares.‡ Three of the *Régents* must be treasury disbursing agents (*Trésorier-Payeurs général*), *i.e.*, officials, and five must come from the business portion of the shareholders, from amongst whom the *Censeurs* also must be chosen. The *Censeurs* are inspectors or auditors. They attend meetings of the *Conseil Général*, have access to the records of the Bank, and are entrusted with the duty of reporting any irregularities to the shareholders.

The *Régents* and *Censeurs* divide themselves up into five committees to deal with special departments, *e.g.*, the *Comité d'escompte*, the *Comité des billets*, &c.

The Managers of the Branches are appointed by the Minister of Finance from amongst three candidates nominated by the Governor of the Bank, who has also the power of dismissal. The names are considered, as well, by the *Conseil Général*.

It will be noticed that, so far as the letter of the law goes, the power of the representatives of the shareholders is very much greater than is the case with the Reichsbank. This is much modified, in practice, by the following considerations. In the first place the Governor has the right of veto. This right, though the occasions of its use in the last hundred years have been very rare indeed, preserves the ultimate authority of the State over changes in policy or regulation unimpaired. In the second place the official element on the *Conseil Général*, made up of the Governor, the two Deputy Governors and the three *Trésorier-Payeurs Général* amongst the *Régents*, commands six votes out of a total

* It originally opened in 1876 with 201 branches.

† *See* Official History of the Reichsbank.

‡ This provision is quite peculiar to the Bank of France. A shareholder has at present to hold about 20,000*l*. worth in order to participate.

of 18. Since the Governor has a casting vote, if only three of the 12 unofficial members vote with the officials, the latter have an assured majority. The practical effect of this has been, in the words of M. Rouland who was Governor in 1865, that "nothing of any "description which concerns the great interest of the public, or the larger duties which "the Bank has to perform towards commerce and industry, is left to the discretion of what "is called the interested party (*i.e.*, the shareholders)."

The Imperial Bank of Russia.

This Bank stands by itself (so far as the larger countries are concerned) in being wholly owned, as well as managed, by the Government. It is under the direct control of the Minister of Finance.

*The Bank of Belgium.**

No part of the capital is owned by the State.

The Governor is appointed by the King for five years, and may be re-appointed. The active administrative council consists of the Governor and six directors appointed by the shareholders. The shareholders also elect a council of seven censors to audit and supervise. The Government exercises further supervision through a Special Commissioner, and Article XXIV. of the Bank Act runs:—"The Government has the right to "control all operations. It shall have the power to prevent the execution of any measure "which shall be contrary to the law, to the statutes, or to the interests of the State."

The Bank of the Netherlands.

Closely similar to the Bank of Belgium.

The Austro-Hungarian Bank.

No part of the capital is owned by the State.

The Governor and two Deputy Governors of the Bank are appointed by the State.

The Bank of Italy.

The capital is privately owned, but the nomination of the Director-General must be approved by the Government; and the Ministers of Agriculture, Commerce, and the Treasury form a board with powers of supervision and inspection.

The Bank of Spain.

This is a private institution, but privileged and standing in very close relations to the Government.

The Bank of Japan.

Baron Sakatami, ex-Minister of Finance, writes as follows:—"When the Bank was "first established, the Government was a very large shareholder, but these shares were "afterwards transferred to the Imperial Household Department . . . . . The Government's supervision is very strict. It appoints the Governor and the Deputy Governor; "the directors are also appointed by the Government from among candidates elected by "the shareholders; the Government appoints official inspectors from among the officials "of the Department of Finance . . . . ."

APPENDIX B.

State Banks and Private Capital.

On the occasion of the last renewal of the Reichsbank Charter in 1909, many people urged that the private shareholders ought to be bought out by the Government on the avowed ground that these were making profits which ought to accrue to the State. The following quotation from an article written by Professor Lexis in the course of this controversy is instructive:—"The officials of a pure State Bank have merely to adapt "themselves to the regulations coming to them from above; but a Bank of issue with "private capital, even when entirely managed by the State, has a sort of independence "as regards the State—an independence which protects it against interference with the "vital conditions of its existence. For the former, indeed, the interference of legislation "is always needed; but the latter must never forget that a great private capital is in its "charge. The Central Committee of the Reichsbank has undoubtedly only a very "moderate authority, but its influence, nevertheless, is far greater than that of the "advisory board of a State railroad company, because it represents the owners of the "bank capital."

* See *The National Bank of Belgium*, by Charles A. Conant.

It was noticeable that the demand for the suppression of the private capital of the Reichsbank came, not from the Socialists, but from the Agrarians. "The Agrarians," it has been said, "wish to render the State master of the Bank, because they are to-day "masters of the State. If the State becomes master of the Bank of the Empire, the "Agrarians hope that nothing can any longer prevent them from compelling the State "to employ the funds of the Bank in the execution of their programme."

There was a similar controversy in Belgium in 1900. The following arguments against the abolition of private capital may be quoted from the *Documents Parlementaires** :—"There is, first, the confusion of public and private credit, to the great damage "of each; for they ought to remain distinct, for their respective good and for the "mutual assistance which they are at times called upon to lend to each other. Further, "there is the acceptance by the State of a task—the task of discounting—which is not "within its competence, and of which, even with the best of will, it will acquit itself "badly. It is neither wise nor practicable to suppress the legitimate stimulus of private "interest in such affairs as discount. It must not be believed that in such a matter "disinterestedness alone suffices or can afford a better guide than the foresight of "those who run the risks and reap the benefits of such operations."

APPENDIX C.

The Division of the Profits of the Reichsbank.

The duties to be performed by the Reichsbank without remuneration and the rules governing the proportion of the profits which accrues to the shareholders are as follows :—

(1) The Reichsbank must purchase gold bullion tendered to it at a fixed rate. It is "required to accept payments for the account of the Empire and to make "disbursements without compensation." It bears the whole expense of management of the note issue.

(2) The Reichsbank must pay a tax of 5 per cent. to the Government on the excess of the fiduciary issue beyond a certain amount.

(3) "The net annual profit of the Reichsbank is to be divided at the close of each year in the following manner :—

"1. In the first place, a regular dividend of $3\frac{1}{2}$ per cent. of the capital is to be distributed among the shareholders.

"2. Of the remainder, 10 per cent. is to be transferred to the reserve fund, 20 per cent. to the shareholders, and 70 per cent. to the Imperial Treasury.

"3. If the net earnings are less than $3\frac{1}{2}$ per cent. of the capital, the difference is to be made up from the reserve fund."

These arrangements, however, have been altered at every decennial revision of the Bank Act. Originally (1875) the guaranteed dividend was $4\frac{1}{2}$ per cent. (instead of $3\frac{1}{2}$ per cent.), 20 per cent. of the balance went to reserve, and of the rest the State took a quarter when the total dividends of the shareholders exceeded 8 per cent. In 1891 $3\frac{1}{2}$ per cent. was substituted for $4\frac{1}{2}$ per cent., and the one-fourth share began to accrue to the State when the shareholders' total dividend exceeded 6 per cent. After 1901 the share of the State began as soon as the $3\frac{1}{2}$ per cent. dividend and the transfer to reserve had been made, and the shareholders received 25 per cent. of the surplus. The present arrangement dates from 1911.

The actual dividends of the shareholders in recent years have averaged about 7 per cent. :—

1907	9·89 per cent.
1908	7·77 "
1909	5·83 "
1910	6·48 "
1911	5·86 "
1912	6·95 "

In 1912 the State received 1,088,732*l.* as its share of profits and 231,374*l.* as note tax 1,320,106*l.* altogether; as compared with 879,881*l.* in 1911, 1,001,139*l.* in 1910, 822,409*l.* in 1909, and 1,280,838*l.* in 1907.

The agreement between the shareholders and the State is subject to revision every ten years. And, further, "the Empire reserves the right of option on January 1, 1891, "and thereafter at the expiration of every ten-year period: (*a*) of discontinuing the "Reichsbank established by this Act, and acquiring its property on the basis of the book "values, or (*b*) of acquiring the total stock of the Reichsbank at valuation . . . . In "either case the reserve fund, in so far as it is not required to defray losses, is to be "equally divided between the shareholders of the Empire."

If at any of the decennial periods the Government had taken full advantage of this provision, it would have been much more disadvantageous to the shareholders than the new arrangements for division of profits actually made.

* See Conant, *History of the National Bank of Belgium.*

NOTE BY SIR JAMES BEGBIE.

I have signed the Report subject to the following note :—

1. I regret that I am unable to concur in the conclusions and recommendations contained in the Report on the subject of the currency policy.

2. That policy has been directed to the attainment of stability in the exchange value of the rupee by means of gold reserves collected from the profits realised on the coinage of rupees. Whilst it has been successful in achieving that object, it has brought into existence an extensive token currency which, in my opinion, is not conducive to the interests of India. I regard that form of currency as undesirable for a country which absorbs gold on a very large scale.

3. A brief examination of some of the chief arguments brought forward in favour of the measures actually adopted for securing stability in the exchange value of the rupee, and of those urged against the use of the means originally proposed for securing stability, viz., a gold currency with gold in active circulation, may help to make my point of view clear.

4. I take first the arguments given in support of the existing policy. The point has been pressed that the public preferred and demanded rupees, and the demand had to be met. That is a reason which carried considerable weight in the early years of the period during which the policy has been developed, but it has now lost its force. The public have absorbed during the last 12 years approximately equal amounts of rupees and sovereigns, but the demand for sovereigns has rapidly increased during the last four years. These recent gold requirements show an important change in the currency needs of the people, and indicate a preference for gold over rupees.

5. The next argument is one which has latterly come into prominence, viz., that the Indian system has close affinities with the currency systems of certain other countries. Such analogies are, I consider, unsafe as a guide to Indian policy, because the conditions are not identical. In none of those other countries is there the same private absorption of gold that there is in India. Whatever experience elsewhere may be, the recent demands for gold in India show a loss of confidence on the part of the public in the token rupee, and that is a situation that should not be ignored. The need for confidence to secure the exchange value of the rupee is recognised, but not the need for confidence in the currency in other respects. It is no longer possible to say that the token rupee is preferred by the Indian public and satisfies their currency requirements in face of the fact that they have latterly exhibited so strong a desire for gold as the statistics indicate. At least there is not now such general confidence in the rupee as would, in my opinion, alone warrant further large extensions of the token currency.

6. Another argument given is that it is desirable to educate people in the use of more economical forms of currency than gold. That, of course, is a desirable object, but the experience so far gained does not inspire the hope that the educative effect of present methods will be successful in attaining it. The increased circulation of notes may be pointed to as an advance towards the use of more economical forms of currency; but it is due, not solely to a desire to economise in currency, but partly at least to increased facilities for the employment of notes. Against this favourable sign must be set the increased absorption of sovereigns. This demand for gold coin, accompanied as it has been by increased demands for gold bullion, dominates the whole currency situation. For a country which takes gold in great quantities an extensive token currency is most unsuitable. It has the usual effect of driving gold out of circulation. It has the still greater disadvantage that it keeps the gold out of useful employment. People who value gold so highly as to store and hold it to the extent witnessed in India are not likely to invest or make other profitable use of it, so long as they have to take the risk of being repaid in token coins when they realise their investments. The token currency not only prevents the holders of the gold from utilising it to some advantage, but the country as a whole loses the benefit that should accrue to it from the possession of great wealth. While, therefore, the process of education in the use of economical forms of currency is proceeding, the probabilities are that the people will none the less continue to amass their growing wealth in solid gold. In my opinion, what is needed is not education in the use of economical currency so much as education in the use of the stored up gold. The first step, however, is to convince the people that if they use their gold they will get it back when they want it, and that cannot be done while there is this extensive and expanding token currency. A currency in which gold was a more prominent feature

and to which token coins were less freely added would be more practical as an educative force. Gold coins would be suitable and convenient for many ordinary currency purposes, and by using them the public would be gradually led to use gold for other purposes, such as investments, especially if a considerable circulation of gold existed, sufficient to inspire the public with confidence that when they wanted their gold restored to them they could get it.

7. I come next to reasons advanced against a gold circulation. It has been said that gold in reserves is better than gold in circulation for the support of exchange. That, of course, is true, but it is equally true that gold in circulation is a better protection for exchange than token coins. Gold in circulation can never endanger exchange stability. It cannot be too strongly emphasised that danger lies in the token currency alone when unfavourable trade conditions prevail. In the words of the Report (paragraph 62), "It is the surplus tokens and not the gold which will seek an outlet at times of weak exchange." Moreover, reserves of gold can be accumulated from a gold circulation through the note issue and a good banking organisation. Even under the existing system the most satisfactory part of the gold reserves is the gold in the Paper Currency Department. The full equivalent of the currency issued against it is saved in gold for the reserve, whereas the Gold Standard Reserve represents only about one third of the token currency from which it was saved, and will redeem only that proportion of it, unless the extreme step is taken of melting down rupees. Also, a considerable portion of the coin reserve of the Note Department must be held in rupees at present. With a free circulation of gold a much smaller portion could be held in rupees and a correspondingly larger part in gold.

8. The objection that gold is an expensive form of currency is one which, I consider, can easily be pressed too far in the case of India. The token currency is being steadily exchanged for gold. To the extent at least to which that process is carried the country is not saved the expense of the gold by the present system. Also, if, as I think is the case, the token currency has the effect of encouraging and strengthening the hoarding habit, it is not true economy to object to the expense of a gold currency, and as a result to force gold out of circulation and prevent its employment in other useful ways, thus causing extreme waste.

9. Another objection is that gold coins, especially coins of small value, would be formidable rivals to currency notes. In my opinion notes will usually be preferred to coin—whether gold or silver—for such purposes as bank cash reserves and frequently for effecting remittances. If the use of notes for other purposes is endangered in any way by a circulation of gold coins because the latter are preferred, it has to be remembered that notes may be affected by the growing demands for gold. The possibility that these demands will spread should be recognised. If the public want gold they will get it whether they hold notes or rupees, and when they prefer gold they are not likely to be satisfied with notes, payment of which can be demanded only in rupees.

10. The hoarding habit in India is no doubt a difficult problem. Its recent rapid development in increased demands for gold, and the possibility of its further expansion, make it a question of the highest importance. I do not, however, think the opinion expressed in paragraph 75 of the Report that "the hoarding habit is "sanctioned by the experience of centuries in India and by religious and racial "laws and customs" sufficiently accounts for the accelerated pace it has latterly acquired. In my opinion, that is to a large extent the outcome of the policy which has brought into existence the extensive token currency. Up to the closing of the Mints in 1893 to the free coinage of silver the public had been accustomed for generations to full value coins for their currency requirements, and they are not now prepared to hold their profits and savings in the form of overvalued rupees. Hence their preference for gold, both coin and bullion. I am therefore unable to agree that the habit is one which should be regarded as inevitable in Indian social or religious conditions and not susceptible to treatment. The statistics show that great progress has been made in attracting the cash reserves of the people into useful and profitable channels, such as investments and deposits with banks. But they also show this later reversion to hoarding on an extended scale, which is thus a retrograde movement, indicating a greater and not unnatural desire for solid security than for profitable returns on investments in a currency medium which does not provide the kind of security now clearly preferred. It seems to me that it is not to the interest of India to have its rapidly accumulating wealth diverted into idle hoards by the token currency policy.

11. But even if that policy has not been the cause of the increased demand for gold, the difficulty remains of drawing hoarded gold into profitable use. Capital is proverbially timid and nowhere more so than in India. If, therefore, the gold held in India is to be attracted into useful employment it can, I think, be done only by providing security that when it is invested the investments will continue to represent gold, and be convertible into gold, by means of a gold currency policy in which the public will have confidence.

12. For the reasons I have indicated, I am of opinion that the true line of advance for the currency policy is to discourage an extension of the token currency by providing increased facilities for the distribution of gold when further increases in the currency become necessary. These greater facilities should, I consider, include the issue of gold coins from an Indian mint of a value more suitable for general currency use than the sovereign and half-sovereign, for the purpose of assisting the distribution of gold when, as is frequently the case, the balance of trade is strong in India's favour and gold arrives in considerable quantities. I also think that supplies of gold coins should be laid down in the up country districts with the object of giving the general public effective opportunities of obtaining gold coins.

13. I do not, however, recommend the dispersal into circulation of any of the existing gold reserves. The maintenance of the exchange value of the rupee should continue to be the guiding principle of the policy, and the reserve accumulated specially to secure the stability of exchange should continue to be specifically set apart for that purpose. But as future additions to the currency become necessary by reason of favourable trade balances, the additions should take the form of gold which will be imported in settlement of the balance of trade. With the present system it is sometimes found necessary to anticipate fresh additions to the currency by providing silver for coinage from the reserves. In my opinion it would be better to issue gold from the Paper Currency Reserve to the public in such circumstances and allow the gold when imported later to accumulate again in that reserve.

14. The procedure which I have suggested would, of course, be applicable only to normal times. Should the situation caused by the crisis of 1907–8 recur, and the gold reserves be depleted to support exchange and the silver reserves inflated, the issue of gold for internal purposes would require to be suspended until the surplus rupee reserves were reabsorbed by the public and the gold reserves restored. So long as such an extensive token coinage is in existence, it is important that the public should use it.

15. I also regret to be unable to assent to the proposals contained in the Report whereby the Treasury balances in India and in London may be utilised for the purpose of maintaining the exchange value of the rupee, and for the provision of fresh supplies of coined rupees. I see no good reason for associating the Government cash balances with currency reserves for purely currency purposes. If the gold reserves should not be strong enough to maintain exchange in a time of difficulty, it would be better to raise additional funds by the issue of temporary loans than to rely upon cash balances for such a purpose.

16. Also, I consider the cash balances an unsuitable source from which to provide supplies of silver for coinage. For example, the balances laid down in London represent mainly the proceeds of Council drafts which are sold throughout the year at current rates of exchange, and frequently at rates well below gold import point. If money so provided in London is used to add rupees to the currency in India it means that fresh rupees are issued at more than the established ratio of 15 rupees to the sovereign.

17. The same objection applies to sales of Council drafts below gold point against the Gold Standard Reserve in India for the re-issue of rupees withdrawn from circulation to support exchange, as in 1909–10, and against that Reserve and the Paper Currency Reserve for the provision of new currency. The necessity for working at gold import point in such circumstances does not appear to be sufficiently recognised, but in my opinion it is most important. To work the system by means of drafts at any other rate not only breaks the standard ratio, but lays Government open to the charge of departing from the standard to secure the profits on coinage.

18. The system by which the proceeds of all Council drafts sold are passed into the general balances of the Secretary of State, and portions are subsequently allocated to the Gold Standard or Paper Currency Reserves is open to the same objection. It seems necessary to separate sales on account of those latter funds from sales for

purely Treasury purposes, as they should be made only at the special rate indicated above.

19. I am not convinced that a good case has been made out for the location of the metallic portion of the Gold Standard Reserve in London. I consider that the portion which the Commission are recommending to be held in gold should be held in India earmarked for the support of exchange, and that when it has to be used for that purpose, it should be issued to the public who want it for export. I should not, however, be in favour of an immediate transfer of the gold now held in London to India. But when the Reserve in London is again drawn upon for the support of exchange, it should not later be restored to London, but should be allowed to accumulate in India in gold.

20. I also consider that the coin reserve of the Paper Currency Department should be held exclusively in India. It is in India alone that the notes for the redemption of which the Reserve is maintained fall to be converted into coin on demand. The transfer of a portion of the Reserve to London is a measure which is not calculated to improve the credit of the note issue and is therefore undesirable. For the same reason, I am unable to approve of the proposal to employ in London a portion of the Reserve in temporary investments.

J. BEGBIE.